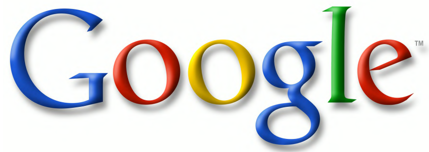


This is a digital copy of a book that was preserved for generations on library shelves before it was carefully scanned by Google as part of a project to make the world's books discoverable online.

It has survived long enough for the copyright to expire and the book to enter the public domain. A public domain book is one that was never subject to copyright or whose legal copyright term has expired. Whether a book is in the public domain may vary country to country. Public domain books are our gateways to the past, representing a wealth of history, culture and knowledge that's often difficult to discover.

Marks, notations and other marginalia present in the original volume will appear in this file - a reminder of this book's long journey from the publisher to a library and finally to you.

Usage guidelines

Google is proud to partner with libraries to digitize public domain materials and make them widely accessible. Public domain books belong to the public and we are merely their custodians. Nevertheless, this work is expensive, so in order to keep providing this resource, we have taken steps to prevent abuse by commercial parties, including placing technical restrictions on automated querying.

We also ask that you:

+ *Make non-commercial use of the files* We designed Google Book Search for use by individuals, and we request that you use these files for personal, non-commercial purposes.
+ *Refrain from automated querying* Do not send automated queries of any sort to Google's system: If you are conducting research on machine translation, optical character recognition or other areas where access to a large amount of text is helpful, please contact us. We encourage the use of public domain materials for these purposes and may be able to help.
+ *Maintain attribution* The Google "watermark" you see on each file is essential for informing people about this project and helping them find additional materials through Google Book Search. Please do not remove it.
+ *Keep it legal* Whatever your use, remember that you are responsible for ensuring that what you are doing is legal. Do not assume that just because we believe a book is in the public domain for users in the United States, that the work is also in the public domain for users in other countries. Whether a book is still in copyright varies from country to country, and we can't offer guidance on whether any specific use of any specific book is allowed. Please do not assume that a book's appearance in Google Book Search means it can be used in any manner anywhere in the world. Copyright infringement liability can be quite severe.

About Google Book Search

Google's mission is to organize the world's information and to make it universally accessible and useful. Google Book Search helps readers discover the world's books while helping authors and publishers reach new audiences. You can search through the full text of this book on the web at http://books.google.com/

Y4.C 73[2]: 94-79

FOREIGN INVESTMENT STUDY ACT OF 1974

STANFORD LIBRARIES

94-2

P101-13

HEARING

BEFORE THE

SUBCOMMITTEE ON FOREIGN COMMERCE AND TOURISM

OF THE

COMMITTEE ON COMMERCE UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

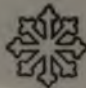
ON

FINAL REPORTS FROM THE DEPARTMENT OF COMMERCE AND THE DEPARTMENT OF THE TREASURY PURSUANT TO THE FOREIGN INVESTMENT STUDY ACT OF 1974

MAY 3, 1976

Serial No. 94-79

Printed for the use of the Committee on Commerce



STANFORD UNIVERSITY
1976
GOV'T. DOCUMENT DEPARTMENT

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1976

Digitized by Google

COMMITTEE ON COMMERCE

WARREN G. MAGNUSON, Washington, *Chairman*

JOHN O. PASTORE, Rhode Island
VANCE HARTKE, Indiana
PHILIP A. HART, Michigan
HOWARD W. CANNON, Nevada
RUSSELL B. LONG, Louisiana
FRANK E. MOSS, Utah
ERNEST F. HOLLINGS, South Carolina
DANIEL K. INOUYE, Hawaii
JOHN V. TUNNEY, California
ADLAI E. STEVENSON, Illinois
WENDELL H. FORD, Kentucky
JOHN A. DURKIN, New Hampshire

JAMES B. PEARSON, Kansas
ROBERT P. GRIFFIN, Michigan
HOWARD H. BAKER, JR., Tennessee
TED STEVENS, Alaska
J. GLENN BEALL, JR., Maryland
LOWELL P. WEICKER, JR., Connecticut
JAMES L. BUCKLEY, New York

MICHAEL PERTSCHUK, *Chief Counsel*
S. LYNN SUTCLIFFE, *General Counsel*
ERIC H. M. LEE, *Staff Counsel*
MALCOLM M. B. STERRETT, *Minority Counsel*
DAVID CLANTON, *Minority Staff Counsel*

SUBCOMMITTEE ON FOREIGN COMMERCE AND TOURISM

DANIEL K. INOUYE, Hawaii, *Chairman*

VANCE HARTKE, Indiana
HOWARD W. CANNON, Nevada
RUSSELL B. LONG, Louisiana
FRANK E. MOSS, Utah
ADLAI E. STEVENSON, Illinois
WENDELL H. FORD, Kentucky

ROBERT P. GRIFFIN, Michigan
HOWARD H. BAKER, JR., Tennessee
TED STEVENS, Alaska
JAMES L. BUCKLEY, New York

Digitized by Google

COMMITTEE ON COMMERCE

WARREN G. MAGNUSON, Washington, *Chairman*

JOHN O. PASTORE, Rhode Island
VANCE HARTKE, Indiana
PHILIP A. HART, Michigan
HOWARD W. CANNON, Nevada
RUSSELL B. LONG, Louisiana
FRANK E. MOSS, Utah
ERNEST F. HOLLINGS, South Carolina
DANIEL K. INOUYE, Hawaii
JOHN V. TUNNEY, California
ADLAI E. STEVENSON, Illinois
WENDELL H. FORD, Kentucky
JOHN A. DURKIN, New Hampshire

JAMES B. PEARSON, Kansas
ROBERT P. GRIFFIN, Michigan
HOWARD H. BAKER, JR., Tennessee
TED STEVENS, Alaska
J. GLENN BEALL, JR., Maryland
LOWELL P. WEICKER, JR., Connecticut
JAMES L. BUCKLEY, New York

MICHAEL PERTSCHUK, *Chief Counsel*
S. LYNN SUTCLIFFE, *General Counsel*
ERIC H. M. LEE, *Staff Counsel*
MALCOLM M. B. STERRETT, *Minority Counsel*
DAVID CLANTON, *Minority Staff Counsel*

SUBCOMMITTEE ON FOREIGN COMMERCE AND TOURISM

DANIEL K. INOUYE, Hawaii, *Chairman*

VANCE HARTKE, Indiana
HOWARD W. CANNON, Nevada
RUSSELL B. LONG, Louisiana
FRANK E. MOSS, Utah
ADLAI E. STEVENSON, Illinois
WENDELL H. FORD, Kentucky

ROBERT P. GRIFFIN, Michigan
HOWARD H. BAKER, JR., Tennessee
TED STEVENS, Alaska
JAMES L. BUCKLEY, New York

Digitized by Google

CONTENTS

	Page
Opening statement by Senator Inouye	1

LIST OF WITNESSES

Berger, Milton A., Director, Office of Foreign Investment in the United States, Domestic and International Business Administration, Department of Commerce; accompanied by George R. Kruer, Chief, International Investment Division, Bureau of Economic Analysis	11
Parsky, Gerald L., Assistant Secretary for International Affairs, Department of the Treasury; accompanied by James Griffin, Director, Office of International Investment	2

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

Berger, Milton A., Director, Office of Foreign Investment in the United States, Department of Commerce, letter of June 4, 1976	47
Parsky, Gerald L., Assistant Secretary for International Affairs, Department of the Treasury, letter of June 1, 1976	44
Study of foreign portfolio investment in the United States—Summary of findings	22

Digitized by Google

FOREIGN INVESTMENT STUDY ACT OF 1974

MONDAY, MAY 3, 1976

U.S. SENATE,
COMMITTEE ON COMMERCE,
SUBCOMMITTEE ON FOREIGN COMMERCE AND TOURISM,
Washington, D.C.

The subcommittee met at 9:15 a.m., in room 5110 of the Dirksen Senate Office Building; Hon. Daniel K. Inouye, chairman of the subcommittee, presiding.

OPENING STATEMENT BY SENATOR INOUYE

Senator INOUYE. This morning the Subcommittee on Foreign Commerce and Tourism will meet to receive the highlights of the final reports on foreign investment in the United States as authorized by the Foreign Investment Study Act of 1974. The complete reports will be made available to the public in the near future as soon as the printing arrangements have been completed.

The legislation, which resulted in the act, originated in 1973, a year in which we witnessed an enormous influx of foreign direct investment. In that year, according to the Department of Commerce's figures, investment inflows surged to an all time high as foreign investors took advantage of several conditions which facilitated—indeed, encouraged—large purchases of equity in American firms.

This unprecedented occurrence in turn stimulated public and political alarm and resulted in the introduction of bills designed to curb foreign investment in this country.

Foreign investment in the United States is an old phenomenon. We owe the growth of several major industries to foreign capital. Foreign involvement here in some form has always been present even in those early postwar years when American capital appeared to dominate totally global investment, but it was the volume and suddenness of the increase which caught the public attention.

As I studied the issues raised by this investment, it became clear that our most pressing need was for more information on this subject. The last benchmark study on direct investment was made in 1959 when such investment was a fraction of the 1973 figure, and that study was limited in its scope.

Information on foreign portfolio investment was derived from an even more outdated benchmark study undertaken by the Treasury Department in 1941. First and foremost, it was clear that the outdated data base needed to be improved, not only in the quality of the numbers, but also in the way information is gathered by Federal agencies.

Staff member assigned to this hearing: Eric H. M. Lee.

Digitized by Google

Rather than succumb to the rising tide of antiforeign sentiment, I decided to concentrate on improving the information available to us and consequently introduced S. 2840, authorizing a comprehensive benchmark study on foreign direct and portfolio investment.

In the House, my colleague John Culver, then a Representative, introduced a similar measure. We shared the belief that the Congress should not make uninformed decisions with wide international ramifications. I believe that time has vindicated our decision.

Too often the debate on this issue had political and economic overtones which prevented an objective evaluation of the benefits and drawbacks of foreign investment. Some defenders of foreign direct investment, including some from the Executive, used figures in a manner to minimize and obscure the true impact of such investment in this country. On the other hand, some critics became too emotional and exaggerated the foreign presence here.

Both approaches should and can be avoided.

Although the debate on the merits or disadvantages of foreign investment has subsided, I have little doubt that this issue will again become prominent in the future.

The United States has become much more intimately entwined with other economies, and as long as capital moves freely, the United States will continue to be an attractive haven for investable funds.

Thus, I would strongly disagree with those who think that the data and analyses in these reports are outmoded. Indeed, we can anticipate that the information in these reports will play a prominent role in the development of future international investment policy.

I would like to close my remarks this morning by noting that there is legislation which Chairman Magnuson and I have introduced to provide for permanent authority to the President and the Secretary of Commerce to undertake periodic benchmark studies as well as to collect certain types of investment information from firms on a regular basis.

This legislation is needed, and I am pleased that it has received the support of the administration, many multinational firms, and organized labor.

Our first witness this morning will be the Honorable Gerald L. Parsky. Assistant Secretary for International Affairs, Department of the Treasury.

STATEMENT OF GERALD L. PARSKY, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY; ACCOMPANIED BY JAMES GRIFFIN, DIRECTOR, OFFICE OF INTERNATIONAL INVESTMENT

Mr. PARSKY. Thank you, Mr. Chairman.

It is a pleasure for me to be here to present to you the findings of the Treasury Department study of foreign portfolio investment in the United States.

It is certainly fitting, Mr. Chairman, that the results of this study be presented to your subcommittee, for this represents the culmination of a process of consultation and cooperation between the Treasury and you and your staff that has extended over a period of more than

Digitized by Google

2 years—beginning with your introduction of the Foreign Investment Study Act of 1974, which provided the authority for us to undertake the study.

The idea for this study originated in 1973, at a time when concern was being expressed over the possible implications of the rise in investments here by European and Japanese interests. Later, the accumulations of funds by the oil-producing countries added to this concern and a number of bills were introduced in the Congress which would impose restrictions on investments from abroad.

The President has resisted these proposals and we have opposed any new restrictions on foreign investment in the United States. We continue to believe that the operation of market forces will direct worldwide investment flows in the most productive way.

Thus, we have sought to maintain our traditional policy of freedom for investments here by foreigners.

At the same time, we did share the view of this committee and others in Congress that adequate information on international investment should be available to all branches of Government and to the public.

Consequently, we strongly supported the Foreign Investment Study Act of 1974, which called upon the Commerce and Treasury Departments to undertake comprehensive overall studies of foreign direct and portfolio investments in the United States and to report their findings within 18 months.

We did not view such legislation as in any way weakening our commitment to the free flow of investment capital. Rather, we saw it as a desire, on your and other Members of Congress part, to insure that the necessary facts were available so that sound policy could be developed.

As you are well aware, the act was passed in October of 1974. Before that, however, in anticipation of its passage, the Treasury had begun laying the groundwork. First, we had to design a questionnaire form for business firms which would supply us with all the statistical data required.

We then had to consult with representatives of the reporting community to assure that the information called for could be supplied at a reasonable cost and in time to allow us to assimilate it and analyze it within the timeframe of the act.

This process was completed in late 1974, and in January 1975 forms were mailed out to business firms.

For the research on some of the nonquantitative parts of the study—why and by what means foreigners invest in the United States and the legal aspects involved—we decided to contract for the services of a private research firm. After reviewing the numerous responses to our solicitation for bids, we awarded the contract to R. Shriver Associates on the basis of its qualifications, work plan, and price.

The collection, review, and analysis of all the information we have gathered has been a substantial undertaking. We have received some 10,000 completed forms from business firms. In addition, R. Shriver Associates has submitted to us reports on their interviews with over 100 persons in this country and abroad who are involved in foreign portfolio investment, and very extensive material on the purpose and effect of United States and foreign laws relating to foreign portfolio investment.

Digitized by Google

A completely thorough review and analysis of this wealth of information takes much longer than the few months which have passed since it became available to us and we will continue to review it for some time to come.

However, the Congress, quite understandably, wanted a timely report on our findings which I am happy to submit at this time.

Attached to my statement is a summary of our findings, which I would request be submitted in full for the record.[1]

Senator INOUYE. Without objection, they will be made part of the statement.

Mr. PARSKY. Later this month we will print and distribute to the Congress and the public a more detailed report.

Now I would like to give you the highlights of the Treasury study.

The comprehensive benchmark survey which we undertook under the study shows that foreign portfolio investment in the United States was approximately $67 billion as of the end of 1974.

This consisted of over $25 billion in stocks, over $16 billion in corporate bonds and other private debt, and nearly $26 billion in U.S. Government bonds and notes.

The total derived from the benchmark survey was about $11 billion higher than our previous estimate; most of this difference, nearly $7 billion—unfortunately my prepared statement says $8 billion; the correct figure is $7 billion, Mr. Chairman—was in the stock figure.

This is not surprising since our previous estimate was based on a survey done for 1941 and both the composition and the value of this portfolio obviously could have changed substantially over a period of 33 years.

Special factors, not directly related to market forces, accounted for most of the foreign holdings of debt instruments in 1974. First, practically all of the holdings of U.S. Government securities were held by foreign official institutions, such as central banks, because of their policies of holding a major part of their international reserves in dollars.

Second, nearly all of the recorded foreign holdings of U.S. corporate bonds are the result of the U.S. Government balance-of-payments programs in previous years when U.S. companies were encouraged to finance their overseas investments through Eurobonds, even if they had to pay a higher interest rate than on borrowings in the United States.

When these special factors are taken into account, it becomes apparent that market-related foreign portfolio investment in this country is primarily in the form of corporate stocks.

This is seen more clearly if we examine the estimates of foreign portfolio holdings as of the end of 1975, which are based on the 1974 survey and our monthly data on foreign portfolio transactions plus estimates of the changes in market values of foreign-held securities, approximately the same process we used up until this benchmark survey, but we based on the figures for 1941.

These estimates indicate that the total foreign portfolio as of end 1975 was $86 billion, of which $37 billion or 43 percent consisted of stocks.

[1] See p. 22.

Digitized by Google

Since stocks play such a dominant role in foreign portfolio investment in this country. I think it is important to comment in a little more detail about these holdings.

The survey showed that virtually every country in the world held some U.S. stocks but the holdings were heavily concentrated in a few countries.

Switzerland, the United Kingdom, and Canada alone accounted for nearly 60 percent of the total and when the Netherlands and France are added, these five countries represented nearly 75 percent of total foreign holdings.

Slightly over half of the total was in the names of foreign banks, brokers, and nominees who were holding these securities in part on behalf of other persons.

This was particularly true in the case of Switzerland where nearly 90 percent of the holdings were in this category, a considerable proportion of which represented holdings for beneficial owners in other countries.

The other categories of major holders were: Individuals, holding $4.5 billion, about half of which was held by U.S. nationals residing overseas; institutional investors, such as investment trusts, with $3.7 billion; other private institutions, $2.5 billion; and foreign official institutions, $1 billion.

The distribution of these holdings by industry was fairly widely diversified and did not differ significantly from that of American investors. Foreign holdings of U.S. stocks were equal to about 5 percent of the value of all publicly traded stocks.

Through interviews with foreign portfolio managers here and abroad, we attempted to assess the reasons for foreign portfolio investment activities in the United States. The principal motivations, which are spelled out in the summary, include:

1. Expectations of long-term capital gains.
2. The relative economic and political stability of the United States. Many European investors, for instance, see the United States as offering more profit potential and less risk of nationalization than other major countries.
3. The large size and liquidity of U.S. capital markets. The lack of depth and liquidity associated with smaller capital markets elsewhere makes it difficult to place large amounts of funds in a relatively short period of time.
4. Close regulation and organization of U.S. securities markets. This serves as a desirable safeguard.
5. Great range of investment choices.
6. Sales efforts of U.S. securities dealers.
7. Greater efficiency of U.S. markets.

In addition to seeking to determine the reasons behind investment activity, we also attempted to identify the processes and mechanisms through which investment is made in the United States.

We found that foreign portfolio investors use the same investment channels as U.S. investors for the most part, namely the New York and American exchanges, the regional exchanges, and the over-the-counter market.

Many of the major U.S. companies are also listed on foreign exchanges.

74-060—76——2

Digitized by Google

Foreigners rely heavily on U.S. brokers and dealers for placing orders and obtaining information on U.S. securities.

The heterogenous nature of the numerous foreign investors in U.S. securities makes it difficult to isolate the effects they have on our financial markets and on our economy.

Nevertheless, it is true that any additional demand for securities in any segment of a capital market tends to raise prices and reduce yields on the type of securities demanded.

Thus, foreign purchases of U.S. stocks and bonds have a tendency to reduce yields and therefore make raising of capital relatively easier for domestic borrowers.

This in turn will tend to stimulate real investment and increase the output and productivity of the economy.

We did find that foreign holdings of U.S. stocks are turned over somewhat more frequently than U.S. holdings.

On the other hand, foreigners as a whole have been net purchasers of U.S. stocks in every year since 1959 except for the years 1964–1966 Thus, they have on balance tended to strengthen stock prices.

Generally, our conclusion is that more participation in our markets tends to make them deeper and more efficient.

Thus, foreign participation, we believe, is beneficial.

The Treasury study also involved comprehensive research into the legal aspects of foreign portfolio investment. While the U.S. legal structure is generally viewed favorably by foreign investors, particularly our securities laws, some aspects are viewed as a deterrent to investments here.

The U.S. withholding tax on dividends and interest payments and the fact that the U.S. estate tax is levied on the U.S. securities holdings of foreign investors are two illustrations of such negative factors.

Mr. Chairman, that provides you with the general outlines of our study. Since one of the major reasons for undertaking this study was the concern expressed by some over the potential of the oil-producing countries to acquire large amounts of assets in this country, before concluding, I would like to make some observations about these investors in particular.

In the early period of the large accumulations by the OPEC countries, almost all of their investments in the United States were in the form of short-term assets, such as Treasury bills and short-term bank C.D.'s. Being cautious and conservative investors, it was natural for them to confine their investments to the safest and most liquid forms at the outset.

This is one of the reasons why our benchmark survey, which was taken as of the end of 1974, shows relatively small holdings for these countries, $2.4 billion, which was less than 4 percent of total foreign portfolio investment in this country.

In 1975 and early 1976, these countries shifted substantial amounts into longer-term assets, primarily Treasury and other Federal agency bonds and notes and corporate stocks; lesser, but not insignificant, amounts were also invested in long-term bank C.D.'s and corporate bonds.

In 1975, OPEC countries made portfolio investments in the United States of about $5.7 billion, and in January and February of this year they purchased probably a little less than $1 billion.

Digitized by Google

Looking ahead, we believe that the oil producing countries will place an increasing proportion of their investments in longer-term debt and equity instruments.

Although investments will continue to be placed in the United States, we must recognize the fact that the rate of new investment by many of the oil producers outside their own countries will decline as they are able to absorb more internally.

With respect to the policies these countries are pursuing, enough time has now passed for us to have a clear picture of their approach to investment.

First, they are cautious and conservative investors. I have spoken to the managers of funds in most of the OPEC countries and in particular in those countries that are now accounting for the great bulk of the oil surpluses, namely Sauli Arabia, Kuwait, and the United Arab Emirates.

Although their internal development objectives differ, they all are following diversified investment objectives similar to any institutional investor.

Second, they are almost entirely portfolio investors and none of them have a desire to acquire or control major U.S. companies.

The Saudi Arabian Government, for instance, has told me that they will not invest in more than 5 percent in any particular company, and recently indicated to us that they currently do not own more than 1 percent of any company.

Further, a country like Kuwait has participated in our markets for years and has always been a most responsible investor.

These characteristics come through quite clearly both in the record of OPEC investments in the United States and in the numerous discussions which I have personally had with their leaders.

I do not believe that these countries would consider investments here which would be against our national interest.

I am also confident that they would consult with us before undertaking any significant direct investments.

In sum, they have been and will continue to be good, sound investors, and I think we should continue to welcome their investments just as we do those of other countries.

Our final tasks under the act were to study the adequacy of our information and reporting programs on foreign portfolio investment and to recommend means whereby this information can be kept current.

The benchmark survey which we have just completed gives us a comprehensive and detailed inventory of foreign portfolio investment as of the end of 1974. The magnitude and composition of this inventory will, of course, change as foreigners continue to buy and sell U.S. securities in the years after 1974.

We will be able to update the major categories of this inventory reasonably accurately for some time to come by adding (or subtracting) our monthly data on transactions to the 1974 benchmark figures and applying estimated changes in the market values of foreign holdings.

The results of the survey suggest that there is some underreporting bias in these monthly data. This was not unexpected and the differ-

Digitized by Google

ences between the totals reported by the survey and those which has previously been estimated do not appear unduly large, in view of the long period of time that has elapsed since the previous benchmark in 1941 and the significance of the nontransaction factors affecting the investment position totals.

It is noteworthy that the difference is substantially larger in the figures on equity holdings, where the valuation adjustment problem is greatest, than it is for holdings of debt instruments.

The survey results, therefore, do not appear to raise major questions about the current reporting system and we believe that the conceptual and institutional structure of this system is adequate.

Nevertheless, it will be necessary to constantly monitor the reports and to maintain close communication with the reporting firms to insure that there are no major gaps in our reporting network.

Although it might be desirable to undertake another benchmark survey at some time in the future, I think that this decision should be left for the future.

The desirability of another survey can then be determined on the basis of how much the increased accuracy of the data would be worth as compared to the costs involved to both the government and the private sector in undertaking a survey.

One important step toward improving our data gathering capability has already been taken by you, Mr. Chairman, in introducing the International Investment Survey Act of 1975.

Thus far, we have been relying on a patchwork of laws to collect data on foreign portfolio investment, laws which are either clearly lacking in some respects or ambiguous as to our authority to collect such data.

S. 2839 would give us broad and permanent authority to collect data on all forms of international investment and we again strongly support its passage with the amendments I proposed in my testimony of February 23, 1976.

My final observations go, Mr. Chairman, to the basic question which gave rise to this study over 2 years ago: Is the magnitude and nature of foreign investment in this country such that a change in our basic policy toward this investment should be made?

As you know, this country has traditionally had an "open door" policy toward foreign investment. We do not impose special barriers to such investment, except for a few long-standing and internationally recognized restrictions, nor do we offer special incentives for such investment.

Furthermore, foreign investors are generally treated equally with domestic investors once they are established here, that is, they are accorded "national treatment."

This policy is based on the premise that investment in this country from foreign sources is generally beneficial to our economy, just as is investment from domestic sources, and that the allocation of investment capital will be most productive if decisions on investment are left to the marketplace.

There is nothing in the findings of our study to indicate that this policy should be changed in any way. On the contrary, the study has reinforced our view that foreign inevstment is beneficial to our economy and that we should continue to welcome it.

Digitized by Google

As long as our national security is protected and as long as the company is willing to abide by our laws and compete in our marketplace, we should not object as to whether its owner is from the United States or France or Abu Dhabi.

The benefits of foreign investment are readily apparent when they are made directly in the form of new plants and equipment—so called "bricks and mortar" investment. In the case of portfolio investments by foreigners, however, it is sometimes thought that we get nothing of substance, that only "paper transfers" are involved since foreigners are merely converting their holdings of liquid dollars into other forms of paper assets, such as stocks and bonds.

This notion overlooks the fact that in the capital investment process there are many different kinds of investors and all of them play a vital role. Portfolio investors, domestic and foreign, broaden the market for U.S. securities, and thereby the opportunities for American firms to acquire the financing needed for new investments in "bricks and mortar."

Even if foreigners never injected capital directly into U.S. firms by buying new security issues, their role would be no less beneficial since the market for new issues is directly dependent on a broad and lively secondary market.

The more participation we have in our capital market, the more efficient it is in serving the needs of our economy for investment capital. The participation of foreign investors serves this purpose just as that of American investors does, and distinctions made on the basis of the nationality of investors have no economic rationale.

The American capital market is the largest and most efficient capital market in the world.

Unrestricted access of foreigners to our market—both as lenders and borrowers of portfolio capital—is beneficial to this market. It is also beneficial to the interchange of goods, services, and capital between nations, which is vital to the growth of the United States and the world economy.

Rather than contemplating new restrictions on foreign capital inflows, we should seek to assure that impediments to these healthy additions to our eocnomy as minimized.

The administration's proposal to remove the withholding tax on dividend and interest payments to foreigners is an important step in this direction.

We should continue to look for other measures we can take to assure that our capital market continues to grow as the world's major international financial center.

Thank you, Mr. Chairman.

That concludes my remarks.

I have with me Mr. James Griffin, who is the Director of our office of investment policy in the Treasury Department, that works with me, and we would be delighted to try to answer any questions you may have.

Senator INOUYE. Being aware of your schedule, I would like to submit most of my questions to your office for consideration.

First, I would like to thank you for your statement. It is very helpful.

Do you have any comparable figures for U.S. overseas portfolio investments?

Digitized by Google

Mr. PARSKY. Yes, our latest estimates for U.S. investment abroad would amount to, on a portfolio basis, approximately $41 billion; and U.S. direct investment abroad, approximately $119 billion, for a total U.S. investment figure of approximately $160 billion.

That would compare to our figure of $67 billion for portfolio, and I know that the Commerce Department will be testifying soon on direct, and I believe the figure is approximately $26 billion, so it amounts to $93 billion here versus $160 billion abroad.

Senator INOUYE. Your summary notes that approximately 25 percent of the portfolio investment is done for nominees.

Do you have any idea of the identity of these nominees?

Mr. PARSKY. Well, we can tell with respect to U.S. nominees. As part of the forms that we sent out, we were able to tell that. What we are not able to tell is the exact nature of foreign nominees, of foreign institutions.

And, from our standpoint for purposes of this study, we don't think that that information is highly significant, because the important factor is whether or not it is a foreign investor that is involved. We were able to tell that, both from our information on U.S. institutions with beneficial owners abroad and the fact that it is an institution abroad, maybe holding for a foreigner.

We know that it would not be of a significant nature, because even if the nominee abroad was holding more than 5 percent for a beneficial owner, that information would have to be reported to the SEC. But we do not have, nor are we able to tell the exact nature of beneficial owners holding U.S. securities through foreign institutions. U.S. institutions, we can.

Senator INOUYE. Your statement indicates that the foreign investors own about 5 percent of our portfolio, and yet the summary states that these holdings are in a relatively limited number of companies.

Wouldn't that tend to indicate that the aggregate impact is greater than the 5 percent would suggest?

Mr. PARSKY. I think if you look at the tables attached as part of our summary, you will see that the diversity is really quite large. In table F we have broken down investment that comes into this country to indicate the concentration of this investment in U.S. firms.

I think you will find, for instance, that the total number of companies with a cumulative foreign investment of 10 percent or over is only 328 companies. So our assessment is that the total impact is not any greater than the 5 percent figure might indicate.

Senator INOUYE. Are you personally satisfied that the assurances given to you by the officials of Saudi Arabia and Kuwait are reliable?

Mr. PARSKY. Yes, sir, I am. I have spent a great deal of time talking to government leaders in these countries, and I am convinced that, in fact, their desire with respect to their investment policy is to be safe, sound, long-term investors. I think they recognize that their investments for their countries now are their insurance for the future, and I believe they will be pursuing the policies I have outlined.

There has been a good deal of publicity given to isolated instances of investments by private citizens from some of these countries, and it has caused a good deal of public concern. But I think if you analyze the situation economically and rationally, I believe you will reach the con-

Digitized by Google

clusion that our country should not be making policy on the basis of fears they will be seeking to either disrupt our economy or control our companies.

Senator INOUYE. In other words, you are trying to tell the committee that there is no evidence that would lead us to concern ourselves that some foreign interests may want to take over certain segments of our economy?

Mr. PARSKY. That is correct, Mr. Chairman.

I don't mean to suggest that we do not have adequate safeguards and that our national security and national defense interests should not be protected. But I believe they are protected by the wide range of laws that are on the books today, and I think we should not be fearful that foreign interests are seeking to control our industry.

Senator INOUYE. Well, I thank you very much.

I know you have just a few minutes to make your flight.

Thank you once again, sir.

Mr. PARSKY. Mr. Chairman, I appreciate it very much.

Senator INOUYE. I will submit questions to you.[1]

Mr. PARSKY. Thank you.

Senator INOUYE. Our next witness is Mr. Milton Berger, Deputy Director of Office of International and Finance, International Economic Policy and Research, accompanied by Mr. George Kruer, Chief, International Investment Division, Bureau of Economic Analysis, Department of Commerce.

Gentlemen, welcome.

STATEMENT OF MILTON A. BERGER, DIRECTOR, OFFICE OF FOREIGN INVESTMENT IN THE UNITED STATES, DOMESTIC AND INTERNATIONAL BUSINESS ADMINISTRATION, DEPARTMENT OF COMMERCE; ACCOMPANIED BY GEORGE R. KRUER, CHIEF, INTERNATIONAL INVESTMENT DIVISION, BUREAU OF ECONOMIC ANALYSIS

Mr. BERGER. Thank you.

Mr. Chairman, with your permission, this is a joint presentation. I would like to lead off, and Mr. Kruer would then discuss the results of the benchmark survey, and then I would complete the testimony.

Senator INOUYE. Fine.

Mr. BERGER. Mr. Chairman, we appreciate this opportunity to report on our study of foreign direct investment in the United States called for under the Foreign Investment Study Act of 1974. That study and the report of the Secretary of Commerce to the Congress should be in final form for delivery to the Congress in a few days.

The report itself will be in two volumes, the first consisting of a number of analytical chapters directed at the specific provisions of the act, together with conclusions and recommendations. The second volume of the report consists of our statistical benchmark survey of foreign direct investments in 1974. In addition, there will be seven volumes of appendices consisting of staff studies and reports by other

[1] See p. 44.

Digitized by Google

agencies and private contractors for the Department of Commerce, which were used as background in preparing the Secretary's report.

All in all, the nine volumes total somewhere in the neighborhood of 2,500 pages. This is the first comprehensive report of foreign direct investment in the United States, although a statistical benchmark survey was issued covering direct investments in 1959.

Within the past year and a half, the department has made a very intensive effort to produce a report which will cover all the significant facets of the subject and provide a broad factual and analytical basis for policy formulation and consideration of legislative proposals in the area.

Given the length of the study and broad scope of its coverage, today we can only provide the broad outlines of its findings. To fully grasp the significance of the findings, however, it would be necessary to examine the report itself, and we hope that many in the Congress and the general public will find the opportunity to do so.

In order to present our findings in a logical fashion, we propose first to discuss the conduct and findings of the benchmark survey and to then discuss the findings and conclusions of the various other analyses undertaken for our report of the characteristics, significance, and effects of foreign direct investment in the United States, together with the applicable policies and laws.

Mr. KRUER. In order to meet the data requirements of the Foreign Investment Study Act of 1974, a comprehensive benchmark survey of foreign direct investment in the United States was undertaken by the Bureau of Economic Analysis, BEA, of the Department of Commerce. Chapter 3 of volume 1 of the final study summarizes the findings of the survey; volume 2 contains a methodology and 132 data tables presenting the results of the survey.

A report was required of every business enterprise subject to the jurisdiction of the United States in which a foreign person had, at any time during 1974, a direct and/or indirect ownership of 10 percent or more of the voting securities of an incorporated business enterprise or an equivalent interest in an unincorporated enterprise. Approximately 7,200 reports were filed with BEA, which, because of consolidation, cover about 10,200 United States legal entities.

The data provide measures of direct investment activity for the year 1974, consisting of, (1) foreign parents' direct investment position in their U.S. affiliates; (2) directly measurable U.S. balance of payments transactions between the U.S. affiliates and their foreign parents, including international trade flows; (3) foreign parents' shares in the earnings of their U.S. affiliates; (4) U.S. affiliates' balance sheets and related financial data; (5) U.S. affiliates' income statements and related financial data; and (6) other data by State, including land owned and leased, and employment and property, plant and equipment.

The investment position. The foreign direct investment position in the United States was $26.5 billion at yearend 1974. This is the value of foreign parents' direct claims on the assets of their U.S. affiliates, net of claims of these affiliates on their parents' assets.

Nearly 80 percent of the total investment position—$21.0 billion—consisted of foreign equity investment in incorporated U.S. affiliates. Outstanding net loans to incorporated affiliates were $4.4 billion. The remaining $1.1 billion was investment in unincorporated affiliates.

Digitized by Google

The United Kingdom, Canada, and the Netherlands had the largest direct investment position in this country, each accounting for about one-fifth of the total. Japan's investment position was only about 1 percent, as substantial outstanding loans of U.S. affiliates to Japanese parents largely offset Japanese parents' investment in their U.S. affiliates. Latin America's 9 percent share came principally from Caribbean-area holding companies. The Middle East's 7-percent share was almost entirely due to one government's participation in a U.S.-incorporated petroleum company with operating assets in that country.

About one-third of the investment position was in U.S. manufacturing, mainly chemicals, food, and machinery. Finance, insurance and real estate combined and petroleum each accounted for about one-fourth of the total. Most of the remainder was in wholesale trade.

Senator INOUYE. May ask questions as you go along?

Can you give us some idea of the identity of the Latin American beneficiaries?

Mr. KRUER. No; we cannot. We did try to ascertain this information as to who was the ultimate owner, where there was a holding company, or where the U.S. reporter indicated that the first-tier owner abroad was not the ultimate owner. I would say probably 75 or 80 percent of the companies did not answer the question, saying either they didn't know or they felt they couldn't give it. Most of them, I would say, said they did not know.

A few did, and we intend to go back and try to trace a little further, in terms of allocating investment, as far as concerns the ones that we do know.

Senator INOUYE. Would you say that most or all of the 9 percent attributed to Latin America are foreign interests?

Mr. KRUER. No. We do know that there are quite a few U.S. owners of some of the foreign companies which in turn own companies in the United States. I think we found this particularly as concerned real estate in Florida. A U.S. citizen may well have a holding company located in the Caribbean area which in turn owns real estate in the United States.

Senator INOUYE. What is the Middle Eastern share in U.S.-incorporated companies?

Mr. KRUER. As you know, we are not supposed to name the companies reporting in the survey; it is one oil company, whose operating assets are located in the Middle East country——

Senator INOUYE. Aramco?

Mr. KRUER. Yes.

Senator INOUYE. Please, proceed, sir.

Mr. KRUER. Yes, sir.

Almost 60 percent of the investment position was in U.S. affiliates wholly owned by foreigners. Most of the remainder was in affiliates owned 50 to 99 percent by foreigners; less than 10 percent was in affiliates with minority foreign ownership.

The investment position increased $5.1 billion during 1974. The increase consisted of net capital inflows of $3.8 billion, reinvested earnings of $1.6 billion, and small negative valuation adjustments.

Adjusted earnings—the foreign parents' return on their direct investment position—were $6.6 billion in 1974. Balance of payments

74-060—76——3

Digitized by Google

income—the porition of adjusted earnings distributed to foreign parents—was $5.1 billion. Most of the earnings and income were accounted for by the Middle East government mentioned above.

U.S. affiliates of foreign parents accounted for a substantial portion of total U.S. merchandise trade in 1974—$24.2 billion, or 24 percent, of U.S. exports and $30.5 billion, or 30 percent, of U.S. imports.

Affiliates' exports of foods—mainly shipments of grain—and industrial supplies and materials were particularly large in relation to total U.S. exports of these goods. Their exports of manufactured goods, on the other hand, were relatively small. Affiliates' shares of total U.S. imports of road motor vehicles and of metal manufactures were significant.

U.S. affiliates of foreign companies dominated U.S. trade with Japan and had sizable trade with Germany.

About four-fifths of total affiliate exports and nearly as much of their imports were wholesale trade affiliates.

Financial and operating data. Total assets of all U.S. affiliates were $174.3 billion at yearend 1974. More than half was accounted for by affiliates of European parents, especially those in the United Kingdom and the Netherlands. Affiliates of Japanese parents had 22 percent, the largest single country share.

Senator INOUYE. Can you give us a brief description of the type of investment the Japanese would have through their affiliates?

Mr. KRUER. In terms of industry, they do have quite a bit in wholesale trade. This was borne out by the trade figures.

But in terms of the investment, typically, the parents would have the required percentage equity ownership and investment, but offsetting this investment is a tremendous amount of loans to the foreign parents by the U.S. affiliates. In other words, they are borrowing in the United States and lending to the foreign parents.

This is why they end up with almost a zero investment position, as we define it for direct investment purposes. It comes out to approximately $100 million, because while they have a large amount of equity investment, we net the investment of the affiliate against the investment by the parent.

Nearly half of total assets, $84.8 billion, were held by affiliates in finance, insurance, and real estate, primarily those in banking. Affiliates in petroleum, manufacturing and wholesale trade each accounted for roughly 15 percent of the total.

U.S. affiliates had sales of $146.8 billion in 1974. Affiliates of European parents accounted for more than half, and those of Japanese parents for more than one-fourth of the total.

Wholesale trade affiliates had sales of $66.5 billion, nearly half of the total, mainly from selling farm-product raw materials, metals and minerals, and motor vehicles. Manufacturing and petroleum affiliates each accounted for about one-fifth of total sales.

The affiliates financed their operations in 1974 largely through increased liabilities, primarily to U.S. banks and other U.S. lenders. Liabilities increased by 38 percent, from $97.4 billion to $134.2 billion. Of the $36.8 billion increase, $10.3 billion was identified as additional liabilities to U.S. banks.

Digitized by Google

U.S. affiliates employed 1,083,000 persons in 1974, with about half of these engaged in manufacturing. Only about 5 percent of affiliates' employees were non-U.S. citizens.

Senator INOUYE. How does the 5 percent break down?

Mr. KRUER. I would say mostly in the professional-technical-managerial area. In one of our tables, we do have a breakdown of principal directors and officers by U.S. or foreign citizenship, and I think it comes out half and half. In each category, it is a little different, but it is approximately half.

By State, New York had the largest number of affiliate employees, 147,000, followed by California, 104,000, and New Jersey, 79,000. In Hawaii, 13,000 persons were employed by U.S. affiliates of foreign persons.

Wages and salaries paid by U.S. affiliates totaled $114.4 billion in 1974.

Total property, plant, and equipment of U.S. affiliates was $45.5 billion. Of the total, about one-fourth—$11.2 billion—was employed in the development of natural resources, about two-fifths, $19.7 billion, in industrial uses, and almost one-third, $14.5 billion, in other business and commercial uses. The Southeastern States had the largest amount of fixed assets, $10.4 billion.

Net property, plant, and equipment was 17 percent of U.S. affiliates' assets, as reported in the balance sheet.

Research and development expenditures by U.S. affiliates were $0.8 billion in 1974.

Mr. Berger will proceed from here.

Mr. BERGER. In addition to the data provided by the benchmark survey, the following findings and conclusions of the various analytical studies contributing to the report should be of interest. These studies were carried out in part by Commerce Department staff and other Federal Government agencies, but also by 10 contractors.

They cover foreign investment motivation, financing mechanisms, labor and management practices, industrial and geographic concentration of foreign direct investments, applicable State and Federal law, accounting and financial reporting practices, taxation of foreign investments, technology flows related to U.S. affiliates of foreign companies, and problems of data gathering.

Foreign direct investment was about 3½ percent of total U.S. nonresidential gross private domestic investment in 1974. Total employment of the foreign-owned companies was a little less than 2 percent of private sector nonagricultural employment.

Not counting petroleum refining, manufacturing facilities owned by foreign investors account for no more than 6 percent of output in any of the broad categories. They have about 13 percent of total U.S. petroleum refinery capacity. Foreign banking has about 7 percent of total U.S. commercial bank assets, and foreign-controlled insurance companies account for 5 percent of total premium income of insurance companies operating here.

Two basic types of motivating forces account for the growth in recent foreign direct investments in the United States, and these are expected to continue. They are: first, the pull caused by the large U.S.

Digitized by Google

market, relatively favorable labor conditions, and, in some cases, access to comparatively inexpensive raw materials or special technologies; and, second, the push of overall economic conditions in other developed countries, accompanied by the increased financial, technical, and managerial capabilities of foreign firms for undertaking large-scale overseas investments.

Foreign firms of Western Europe and Japan that had developed export markets in the years following World War II by the late 1960's or early 1970's had caught up with U.S. firms in technological and management skills. This factor, accompanied by the gradual equalization of U.S. labor costs with these abroad and two dollar devaluations led some foreign firms to serve the U.S. market by establishing or acquiring plants in the United States. Access to raw materials was important in other cases, particularly in Japanese investments in timber and coal, partly through long-term supply contracts.

Foreign firms use many sources and combinations of sources of funds in financing their investments in the United States. The use of foreign sources is significant, particularly in the initial investment stage. However, in 1974, U.S. banks and other U.S. sources were the largest suppliers of capital for all foreign-owned affiliates in the United States.

An investigation of the management and labor practices of foreign-owned subsidiaries in the United States, carried out as part of the Commerce study, found that practices of such companies were generally similar to traditional U.S. practices. In most of these companies, employment increases resulted from the investment—whether startups or acquisitions.

U.S. nationals were found to predominate in managerial positions. Although it was not possible to thoroughly investigate all aspects of labor-management practices, the findings indicate there is not an unfavorable impact on the United States economy and U.S. working conditions.

Foreign direct investment was reported not to be the predominant vehicle for the transfer of technology into or out of the United States. However, technology transfers associated with such investment are significant. In the area of product and process technology, the net balance seems to be into the United States, but in the area of management innovations and marketing techniques, the net flow appears to be outward.

U.S. taxation is not a key determinant in the basic decision to make a direct foreign investment in the United States, although it bears on choices of financing methods, business strategy and the disposition of earnings. Tax treaties, home country exemptions and foreign tax credits moderate the burden of the U.S. tax.

For the Nation as a whole, the study has not found a strong factual basis for concern about foreign ownership of agricultural land and other real estate. However, the inadequacy of data in this field, together with the use of indirect means of obtaining ownership and techniques to avoid ownership disclosure, results in much uncertainty as to the amount and nature of land owned by aliens, except for a few local areas for which special investigations have been undertaken and that are summarized in the Commerce report. There is a need for further investigation.

Digitized by Google

Senator INOUYE. By this statement, are you suggesting the investment might be much larger than reported?

Mr. BERGER. That is right, sir. We think there is a good deal we don't know about. The special surveys that were conducted all face the same problem of not being able to go beyond the legal ownership, not to be able to determine the beneficial ownership.

As you know, the inadequacy of the reporting mechanisms, so far as identification of foreign ownership is concerned, is such that there is very little we can do. It is administered at the State level, so what you know may only be the tip of the iceberg.

We have no strong indications of very extensive foreign ownership beyond what we have identified.

Senator INOUYE. But wouldn't amendments be required to carry out what you suggest?

Mr. BERGER. Yes, sir, it would require amendments perhaps in terms of uniformity at the State level rather than in terms of any Federal land legislation—land identification legislation.

Senator INOUYE. Would the present disclosure laws be sufficient?

Mr. BERGER. Beg your pardon?

Senator INOUYE. Are the present disclosure laws sufficient for your purposes?

Mr. BERGER. We don't think so. If it is important to determine the alien ownership, then the present laws are inadequate.

I think the question that has to be asked is, how important is the need to know? Is it a local matter, a matter at the State level? Is it a Federal matter; are there issues which justify introduction of something at the Federal level?

Senator INOUYE. Thank you very much.

Please proceed.

Mr. BERGER. The Federal Government's collection of data on foreign direct investment is scattered among many agencies, and coordination of these activities is being undertaken. With the establishment of the Interagency Committee on Foreign Investment in the United States and the Office of Foreign Investment in the United States with the Commerce Department, a framework now exists for improving the collection and analysis of pertinent data.

Also, the 1974 benchmark survey provides more complete data than was previously available. However, additional regular mandatory statistical surveys and a regular statistical collection program not now possible under present legislative authority are needed to provide continuing current data and special studies.

As you know, the administration has indicated its support of S. 2839, a bill introduced by you, Mr. Chairman, which would provide the necessary authority to collect such information in the future.

While our study does not lead us to conclude that the size, growth, practices or economic effects of foreign direct investment in this country require a change in our policy or basic treatment of such investments, we are convinced that the maintenance of an appropriate policy and public acceptance of such a policy are dependent on a continued awareness in the government and on the part of the general public of foreign investment activity and its implications.

The executive branch monitoring program already undertaken, buttressed as required by legislation providing the necessary authori-

Digitized by Google

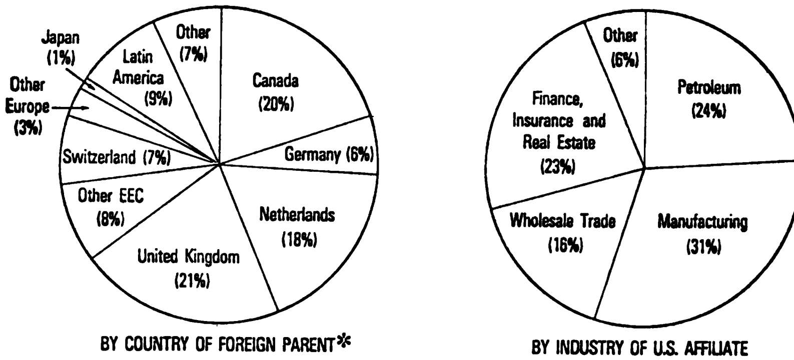
zation for data gathering, should go a long way toward meeting that objective. In addition, some examination of existing restraints on foreign investment seems in order to assure that uncertainties and inconsistencies in the pertinent laws and their application are minimized.

That concludes our statement, Mr. Chairman. We would be very happy to answer any questions.

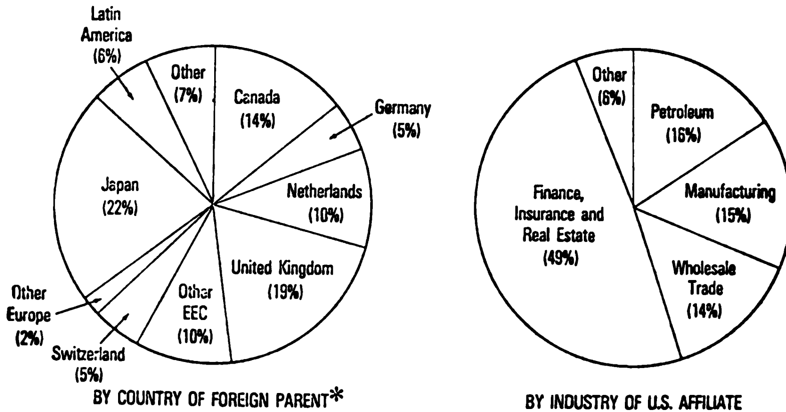
[The charts follow:]

Figure 1. Distribution of Foreign Direct Investment Position in, and Total Assets of, U.S. Affiliates, Year-end 1974

Foreign Direct Investment Position: $26.5 Billion

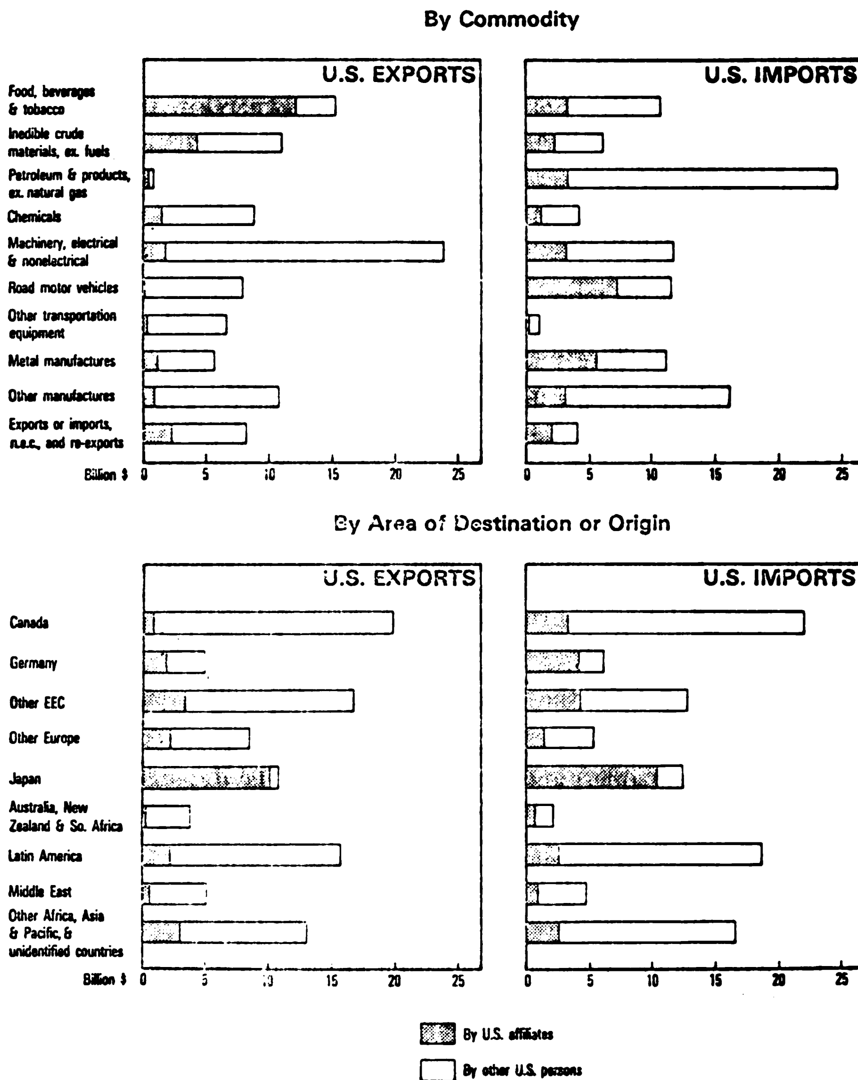


Total Assets of U.S. Affiliates: $174.3 Billion



* Where there was direct ownership in a U.S. affiliate by more than one foreign parent, the portion of the direct investment position attributable to each parent is classified by each parent's own country. Total assets are classified by the country of the foreign parent having the largest portion of the direct investment position. Parents in Latin America are largely holding companies in the Caribbean area owned by residents of other countries, including the United States.

Digitized by Google



Senator INOUYE. Thank you very much.

I have several questions here, most of which I will submit to you for your careful examination.

I would like to ask you a few at this time.

You have indicated that the foreign investment position was $26.5 billion at the end of the year 1974.

The official U.S. figure given earlier was $21.7 billion.

How do you account for that difference?

Digitized by Google

Mr. KRUER. There are three or four major factors which we know of. One of course, is the difference in definition, the change to include 10 to 24 percent ownership whereas the previous figures included only 25 percent and above. It now runs from 10 to 100. I think this gave us a difference of about $1.2 billion.

In addition, there was a much better coverage of what we call foreign affiliates of the foreign parents. These are affiliates of the foreign parent which are located in a different country from the foreign parent and does not have any direct ownership in the U.S. affiliate, but does have financial dealings with it.

By definition, we include this in direct investment. However, in the current quarterly surveys, we get only a few reports covering these types of transactions and we found there was some, oh, I think possibly another billion dollars there.

The other was better coverage of the real estate industry, where we know we picked up more affiliates because of the efforts extended to get better coverage and also because a lot of these are of smaller size and exempt from current reporting requirements.

Then, there would just be other companies along the line that we hadn't gotten in the past, but are picked up because we made a better effort this time.

Senator INOUYE. You state that Japanese investments total only 1 percent of FDI. How does this account for the enormous shares which Japanese affiliates have in sales and other financial categories? Furthermore, you note that substantial outstanding loans of U.S. affiliates to Japanese parents largely offset their investments in U.S. affiliates. Could this kind of a financial arrangement be seen as a covert way of Japanese firms repatriating their capital investments or are Japanese companies purchasing deliberately cash-rich American firms?

In short, what is the explanation for this type of corporate behavior?

Mr. KRUER. I would say it's not the latter. Particularly since it's the trading companies, and most likely, where the Japanese are concerned, these are 100 percent owned, and they have been established by the Japanese parent companies. A lot of this nominally relates to the turmoil in the currency markets in 1972 and 1973 and, of course, the petroleum crises in 1974, when Japan was somewhat concerned about its balance of payments because of the tremendous increase in the price of oil.

These companies were either loaning money to the foreign parents or not paying for their purchases.

We found in some cases, they were prepaying for their future imports from the foreign parent.

Senator INOUYE. Is this type of arrangement prominent only among the Japanese?

Mr. KRUER. No. There were two other countries where there were substantial amounts of the reverse loans.

Senator INOUYE. What countries?

Mr. KRUER. I believe it was the United Kingdom and the Netherlands, but I'm not positive. I can check and give you an answer with the written questions.

Digitized by Google

Senator INOUYE. Secretary Parsky stated earlier that 90 percent of the investments from Switzerland are for nominees.

Do you have any more information as to the nature and character of these nominees?

Mr. KRUER. Again, for ourselves, no. Although a lot of the Swiss investment we have in direct investment, we believe is actually Swiss investment, although I think there is some for other countries.

We find in direct investment, a lot of them go through the holding company areas in the Caribbean and also such places as Luxembourg and Liechtenstein.

But, the Swiss do have large investments directly on their own.

Senator INOUYE. There was a time when many citizens expressed concern that the OPEC countries would suddenly deluge this country with investment and take over a part of our economy.

Does your study indicate any such capital movement?

Mr. KRUER. No. I did pull together a few figures on the investment by OPEC countries. Of the 13 OPEC countries, 6 did not have any identifiable direct investment in 1974. The 7 countries with investments in the United States had 83 affiliates, with Venezuela having 40; Iran, 14; Kuwait, 7; Saudi Arabia, 6; Ecuador, 11; Indonesia, 4; and Gabon, 1.

The affiliates had total assets of $8.9 billion, however, approximately 90 percent of this is accounted for by the one Middle East country, which has a participation in the U.S. incorporated company whose production assets are located in that country. Only about $150 million are assets of affiliates in the U.S. real estate industry.

Senator INOUYE. But you still have no idea as to whether the Swiss investments are from OPEC countries?

Mr. KRUER. No.

Senator INOUYE. In his book, "The American Challenge," Servan-Schreiber repeated one of the European criticisms of U.S. investment, namely that, in Europe, the Europeans were helping Americans to finance the purchase of their own industries. It would appear that this same pattern holds true here, too, that our financial institutions are helping foreign investors to gain control of U.S. businesses.

Mr. BERGER. I believe, to some degree, that is true. We have made an investigation of the financing techniques of foreign investors, direct investors in the United States, and there is a wide variety of sources of financing, as you would imagine.

The newer companies to a large degree derive their investment funds from the home country, the parents' corporate resources, or from banks in the home country. As the companies get more established here, they tend to borrow in the United States.

There is no indication of any inordinate amount of borrowing in the United States; it is consistent with the type of borrowing that is carried on by American companies.

Senator INOUYE. In carrying out the survey, do you find that all of the major companies contacted, responded affirmatively, and cooperatively?

Mr. KRUER. Well, I would say that they did only with a fair amount of encouragement. Most of them did. There was only one large company which did not respond.

74-060—76——4

Digitized by Google

Senator INOUYE. What company was this?

Mr. KRUER. Engelhard Minerals and Chemicals.

We got a report from them only about 3 weeks ago, I think. Therefore, it is no included in the results we have here.

There are a number of other smaller companies, and I say very small. I don't think they would add anything to the numbers one way or the other. There are some that didn't respond at all, but, as far as we can tell, they were very small. We do have a few more reports which we could add to the statistics, but they would say nothing significant, other than the one company.

Mr. BERGER. Apart from the statistical survey, Mr. Chairman, we did contact, through our contractors, a large number of foreign firms for a number of purposes, in ascertaining their management practices, labor practices, motivations, and so forth.

We did get a good deal of cooperation. The contractors felt they were not turned down very much. There was no mandatory requirement for them to supply information, yet they seemed to feel their interests were served by being cooperative in the investigation.

Senator INOUYE. Are you satisfied that this study is a sufficiently reliable one?

Mr. KRUER. Yes.

Senator INOUYE. I presume that you support the measures that would grant you authority to carry on, on a regular basis, the benchmark studies?

Mr. KRUER. We certainly do.

Senator INOUYE. How soon would this study be updated from your professional standpoint?

Mr. KRUER. We had hoped to do benchmark surveys of both inward and outward investment once every 5 years. As your bill provides, and as we have discussed, with amendments, they will not be done more than once every 10 years.

It depends, if we seem to get another large surge of investment, as we may have had in 1973 and 1974, it might be 5 years.

If everything seems to go along just normally, with no particular reason for a large surge, we might go closer to the 10-year period.

Senator INOUYE. Well, once again, gentlemen, I thank you very much for your participation this morning.

I would like to submit to you a list of questions for your consideration and response.[3]

With this, these hearings will stand in recess, subject to the call of the Chair.

[Whereupon, at 10:17 a.m., the hearing was adjourned, subject to the call of the Chair.]

[The following information was subsequently received for the record:]

STUDY OF FOREIGN PORTFOLIO INVESTMENT IN THE UNITED STATES—SUMMARY OF FINDINGS

(From the U.S. Treasury Department, Office of the Secretary, May 3, 1976)

INTRODUCTION

This is a summary of the final report on the findings of a study of foreign portfolio investment in the United States that the Department of the Treasury

[3] See p. 47

Digitized by Google

has recently completed. This study was undertaken pursuant to the Foreign Investment Study Act of 1974 (Public Law 93–479) which authorized and directed the Secretaries of the Treasury and Commerce "to conduct a comprehensive, overall study of foreign direct and portfolio investments in the United States." In dividing this responsibility, the Act drected the Secretary of the Treasury to undertake that part relating to foreign portfolio investment while the Secretary of Commerce was to cover foreign direct investment. The Act called for interim reports on the findings of the two studies by October 1975 and final reports six months later.

The term "foreign portfolio investment" generally refers to foreign investments in U.S. securities that do not involve any significant influence on the management of the enterprise. The definition used for the purpose of this study covers investments in the United States in voting stocks involving less than 10 percent ownership by the foreign investor, in non-voting stocks, and in debt instruments with maturities of more than one year by persons residing in foreign countries (other than non-voting stock and debt owned by a "direct investor").

It should also be noted that the term "foreign" includes U.S. nationals residing abroad and excludes foreign nationals residing in the United States.

The idea for this study originated in 1973, at a time of increasing public concern over the possible effects on our economy of a rise during that year in investments here by European and Japanese interests. It received a further impetus the following years as the focus of this concern shifted to the oil-producing countries, who had begun to accumulate substantial amounts of investable surplus funds as a result of the increase in oil prices.

During the earlier phase of this concern, the Executive Branch undertook an overall review of U.S. policy toward foreign investment here. The conclusion of that review was that we should maintain our traditional "open door" approach to such investments, under which we (1) offer no special incentives to foreigners to invest in this country and, with a few exceptions, no special barriers, and (2) treat them equally with domestic investors once they are established here. It was also concluded, however, that we needed more information on foreign investment in this country.

Thus, the Executive Branch welcomed the bill which authorized this study of foreign investment in the United States when it was introduced in the Congress in December 1973. Officials of the Executive Branch testified in favor of the bill in both houses of Congress and their staffs worked closely with congressional staff members to refine it during the following months. In the fall, both the House and the Seante passed the bill by substantial majorities and on October 26, 1974, the President signed it into law.

Well before the Act was passed, the Treasury staff had already completed a substantial amount of groundwork on this study—the first of this type to be done since 1941. A major part of the study was a statistical survey to collect data on foreign portfolio investment in this country. In this effort, first priority was given to determining exactly what data were needed and then designing forms and elaborating regulations that would facilitate its colletcion. Consultations were held with representatives of potential reporters to ensure that they could produce the required data at a reasonable cost to reporters and within the time frame set by the Act.

The final reporting forms and regulations were mailed to potential reporters in January 1975 with a deadline of March 1 for their completion and return. In total, more than 10,000 forms were completed and returned to the Treasury.

For some of the non-quantitative parts of the study—relating mainly to the institutional and legal aspects of foreign portfolio investment in the United States—the Treasury contracted for the services of a private consulting firm. In accordance with established legal procedures, the Treasury released a "request for proposals," soliciting bids from qualified firms. A number of firms responded to the request, and the contract was finally awarded to the firm of R. Shriver and Associates.

The contractor's work plan involved two major tasks in regard to the institutional aspects of the subject:

(1) A survey of the reasons for foreign portfolio investment activities in the United States.

(2) Identification of the processes and mechanisms through which foreign portfolio investment is made in the United States, the financing methods used, and the effects of foreign portfolio investment on American financial markets.

Digitized by Google

The bulk of the contractor's effort consisted of interviews with more than 100 individuals in prominent financial institutions, both here and abroad, that are active in foreign portfolio investment in the United States. The institutions covered included investment banks, broker/dealers, stock exchanges, industry associations, bank trust departments, investment advisors, U.S. subsidiaries of foreign financial institutions, and insurance companies. The foreign countries in which interviews were conducted were: Canada, France, Hong Kong, Japan, the Netherlands, Switzerland, the United Kingdom, and West Germany.

The contractor's legal work was directed toward an analysis of the purpose and effects of U.S. laws and regulations that relate to foreign portfolio investment here. Information was obtained through study of the laws themselves and their legislative histories, discussions with officials of Federal and state government agencies, and interviews with representatives of the financial communities in the United States and selected foreign countries.

The Treasury's overall progress on the study through early October 1975, was reported in an Interim Report to the Congress, which was released on October 26. The past six months have been devoted to bringing our data collection and research efforts to an end, assimilating the results, and formulating our conclusions and recommendations. The remainder of this report is a summary of the findings of this study. The full report will be printed and made available to the Congress and the public in the near future.

THE BENCHMARK SURVEY

The major undertaking of the Treasury study was a comprehensive benchmark survey of foreign portfolio investment in the United States as of the end of 1974. The Treasury Department has been collecting monthly and quarterly data on foreign portfolio investment in the United States for many years; however, this reporting program was not designed to yield the detailed data called for in the Foreign Investment Study Act. Furthermore, the continuing report series covers the *flow* of foreign portfolio capital into and out of the United States at transactions values; it does not show what the *stock* of this investment is, i.e., the total outsanding value of such investment at a given time.

The last complete survey of the outstanding amount of foreign portfolio investment in the United States was done by the Treasury Department for 1941. Working from this benchmark, the Department of Commerce has made annual estimates of the amounts outstanding by estimating changes in the market value of the investments held by foreigners and adjusting for recorded inflows or outflows in each year. Obviously, the use of such data over a period of more than 30 years can result in substantial differences between the estimated and actual amounts. Therefore, the first major task of the study was to undertake a new survey of the stock of foreign portfolio investment in the United States.

The data for the benchmark survey were collected from two sets of reporters. The first set was the "issuers" (i.e., of securities or long-term debt) themselves—U.S. corporations, partnerships, investment companies, and other organizations and persons subject to the jurisdiction of the United States. These persons were required to provide, on the basis of their own records or those of their transfer agents, a detailed listing of direct foreign-resident ownership of each of their securities or their long-term debt disaggregated by country of residence and type of foreign-resident owner.

In many cases the name and address shown in the issuers' records are not those of the final beneficial owner, but rather those of a "nominee" holder of record, usually a broker or a bank, who holds the securities on behalf of the benefical owner. If such a nominee is a U.S. person, he may hold these securities for foreign as well as domestic owners. A second set of report forms, therefore, had to be collected from U.S. holders of record who held U.S. securities for foreign accounts. These forms required information to be filed on the county of residence and type of holder for each of the securities held for foreign persons.

The results of this survey show that foreign portfolio investment as of December 31, 1974, was $67 billion. This compares with previous estimates published by the Commerce Department of about $56 billion. The total consisted of five broad categories of investments as follows:

Digitized by Google

	Amount (billions)	Previous estimate
Stocks	$24.7	18.0
Corporate bonds	7.4	7.8
Other private debt	8.3	6.6
U.S. Treasury bonds and notes	23.8	22.0
Other Federal, State, and municipal debt	2.4	2.2
Total	67.1	56.4

Some $27.4 billion of the total represented the holdings of foreign official institutions, mainly central banks, monetary authorities, and international lending agencies. Of this amount, nearly $23 billion consisted of U.S. Treasury bonds and notes, more than half of the total U.S. debt held by foreigners. Most of these official holding represented international reserves of the countries concerned, placed in the United States because of the unique position of the dollar as the world's chief reserve currency.

The volume of these official holdings is determined mainly by balance-of-payments factors, independently of the ability of U.S. financial markets to attract foreign capital through the operation of normal market forces. Only to a small extent, such as investments of official pension funds and some of the more recent investments of the Middle East oil-exporting countries, do official funds move primarily in response to market criteria.

Another important special factor affecting the survey totals was foreign holdings of U.S. corporate bonds and other long-term debt resulting from the U.S. Government capital control and restraint programs during the period from the mid-1960's to the early 1970's. Under these programs, U.S. firms were encouraged to go to foreign capital markets to raise the necessary funds to finance their direct investments abroad in lieu of moving funds from the United States to foreign countries. As a result, U.S. firms placed a large volume of both straight and convertible bonds abroad, so-called Euro-bond issues, and additionally raised funds through direct loans from foreign banks. When this was done by bond issues of U.S.-incorporated entities, such as finance affiliates incorporated in Delaware, foreign placements resulted in an increase of foreign portfolio holdings of U.S. bonds and other long-term debt.

It should also be noted that the reporting date of the benchmark survey fell in the the early period of the large accumulations of funds by the oil-producing countries, before these countries had a full opportunity to allocate their holdings across a balanced and diversified portfolio. Consequently, the end-1974 holdings of these countries in the United States were heavily concentrated in short-term assets, which are not included in the survey. In 1975 and early 1976 the oil-producing countries moved substantial amounts of their U.S. holdings into longer-term assets.

Finally, it should be noted that the reporting date of the survey followed a period when the U.S. stock market was in a deep slump and the general lack of buyer interest in U.S. stocks was also applicable to foreigners. In 1975 and early 1976 there was a strong upsurge in foreign purchasers of U.S. stocks, which, along with the sharp increase in the value of U.S. stocks held by foreigners as of end-1974, considerably increased foreign holdings of U.S. stocks, both in absolute terms and as a proportion of the total foreign portfolio of U.S. assets.

When all these factors are taken into account, it is seen that foreign interest in U.S. assets as market-related portfolio investments is primarily in the form of U.S. corporate stocks. Consequently, most of the data and analysis in this report are directed to these holdings.

Foreign Holdings of U.S. Stocks

The foreign holdings of U.S. stocks of about $25 billion as of end-1974 were widely diversified by U.S. industry but heavily concentrated by the recorded country of residence of the foreign holder. While virtually every country in the world was recorded as holding some U.S. stocks, three countries, Switzerland, the United Kingdom and Canada, accounted for 58 percent of the total and when the Netherlands and France are added these five countries alone accounted for 75 percent of the total.

Digitized by Google

These recorded country distributions are somewhat misleading, however, because of the so-called "nominee problem." Some holders of record of U.S. securities—"nominees"—hold these securities on behalf of other persons. Where these nominees were U.S. persons, subject to U.S. law, they were required to report the country of residence and the type of foreign persons on whose behalf they were holding securities as of end-1974. The existence of *U.S. nominees*, therefore, was not a significant problem in the collection of data for the survey. The existence of *foreign nominees*, however, who are not subject to U.S. law and the reporting requirements, did present a problem. Holdings by these foreign nominees disguise the true country of residence and the type of beneficial owners of U.S. securities to an unknown extent.

A further difficulty is that there is no way to determine how much of foreign-held U.S. securities are held by foreign nominees since the U.S. reporter often does not know whether the foreign holder indicated on his records is holding the securities for his own account or on behalf of some other person. In order to minimize this second difficulty, a category of foreign holders called "banks, brokers and nominees" was put in the questionnaire under the assumption that foreign banks and brokers who are holders of record of U.S. securities are, for the most part, holding these securities for other persons. The validity of this assumption varies from country to country, however, and it can only be said that the totals shown for "banks, brokers and nominees" are assumed to be the maximum amounts held by nominees in each foreign country.

This category of foreign holder accounted for $13.1 billion, or slightly more than half of total foreign holdings of U.S. stocks. In the case of Switzerland, 88 percent of total holdings was recorded in the names of banks, brokers, and nominees, and for France the comparable percentage was 68. For the other major holders of U.S. stocks, U.K., Canada and Netherlands, the proportions accounted for by this category were considerably less.

It should not be assumed, however, that the total for this category of foreign holders mostly represents holdings on behalf of persons residing in countries other than the countries of the nominees. Only in the case of Switzerland is it believed that the bulk of nominee holdings is for the account of persons in other countries, and even there a significant proportion is believed to be for the account of Swiss residents.

Of the $11.6 billion of foreign holdings of U.S. stocks held directly by types of holders who are presumed to have been the beneficial owners (that is, all holdings except those of "banks, brokers, and nominees") $4.5 billion was held by individuals, divided almost equally among U.S. nationals residing in foreign countries and foreign nationals. About $3.7 billion was held by institutional investors such as investment companies, insurance companies and pension funds. Various other private institutions accounted for $2.5 billion. Foreign official holdings at the end of 1974 amounted to a little less than $1 billion.

The distribution of foreign holdings of U.S. stocks by industry does not seem to differ much from that of American investors; evidence of this is found in the roughly similar industrial distribution of foreign holdings and the total value of stocks listed on the New York Stock Exchange.

There were 330 companies in which the total private portfolio ownership exceeded 10 percent of the stock outstanding; foreign portfolio investment in the voting stock of these companies amounted to $7.5 billion, and they consisted for the most part of large well-known firms whose stock is apparently very popular with foreign investors. An additional 536 companies fell in the five-to-ten percent range of foreign ownership, accounting for $6.6 billion of the portfolio investment in U.S. stocks; the remaining $9.8 billion was invested in 4,423 companies where the ownership was less than 5 percent.

Foreign holdings of U.S. stocks revealed by the survey are considerably higher than those previously published by the Department of Commerce, but not surprisingly so, considering the degree of estimation that necessarily enters into the Commerce Department estimates. One reason for the difference may well be the rather unexpectedly large holdings of stocks by U.S. citizens residing abroad. If these securities were in the main purchased by such citizens at the time they were U.S. residents, their acquisition would not have been reflected in the balance-of-payments statistics and therefore would not have been taken into account in the Commerce Department's estimates.

Digitized by Google

Foreign Holdings of U.S. Private Debt

U.S. private debt instruments held by foreigners as of end-1974 totaled $16.2 billion, of which $1.5 billion was held by foreign official institutions, including international institutions.

Foreign private holdings were about equally divided between corporate bonds and other forms of private long-term debt. As noted earlier, the bulk of foreign holdings of U.S. corporate bonds is the result of U.S. Government balance-of-payments measures to encourage the issue of Euro-bonds and thus is not truly indicative of foreign interests in U.S. corporate bonds as in the case of U.S. stocks. Nearly all foreign holdings of U.S. corporate bonds were accounted for by these Euro-issues.

Of the $7.3 billion of other forms of U.S. private debt held by private foreign holders, $6.1 billion represented notes and loans, and about one-half of the remaining forms of debt were accounted for by long-term bank certificates of deposit.

Foreign holdings of U.S. private debt were recorded as almost entirely in the hands of institutions, primarily banks, brokers and nominees, with individuals accounting for less than $1 billion. By geographic regions, the holdings were heavily concentrated in a few European countries and Canada. The United Kingdom was the largest holder of U.S. private debt with about 25 percent of the total.

When compared to the total amount of U.S. private marketable debt outstanding it is seen that foreign holdings were not a significant amount. Total foreign holdings of U.S. corporate bonds accounted for only about 3 percent of total U.S. corporate bonds outstanding as of December 31, 1974.

Dividend and Interest Payments

The survey questionnaire required reporters to provide information on dividend and interest rates applying to their stock and debt issues outstanding. Information was also obtained on interest rates applying to government securities, and on other payments of income to owners or creditors of non-corporate business firms. Applying these payments to the shares and long-term debt held by foreign owners as of December 31, 1974, gives an annualized income to foreign portfolio investors of $4,621 million.

Heretofore, estimates of investment income payments in the balance of payments have been based on an assumed yield applied to estimated foreign portfolio investment. For the year 1974 these income payments were estimated at $3,779, about 18 percent less than the survey estimate.

Income payments derived from the survey indicated an overall yield of nearly 7 percent, about 6.4 percent on foreign holdings of stocks, and 7.2 percent on foreign holdings of long-term debt. By comparison, current balance of payments yields on total foreign portfolio investments equalled about 6.7 percent. It appears that the higher income amounts shown in the Treasury survey are not so much based on notably different yields applied to foreign-owned assets, but rather on the higher amount of foreign investment here established in the survey.

TABLE A.—SUMMARY OF FOREIGN PORTFOLIO INVESTMENT BY MAJOR AREA AND TYPE OF INVESTMENT

[In millions of dollars]

Area	Total	Equity	Debt
Total	67,098	24,671	42,427
Europe	45,326	17,562	27,764
Canada	8,338	3,580	4,758
Latin American Republics	971	618	353
Other Western Hemisphere	1,771	904	867
Middle East oil exporting countries	2,098	518	1,580
Other Asia	5,820	913	4,907
Africa	84	61	23
Other countries and unallocated	423	170	253
nternational organizations	2,271	348	1,923

Digitized by Google

TABLE B.—FOREIGN PORTFOLIO INVESTMENT IN STOCKS BY MAJOR AREA AND TYPE OF FOREIGN HOLDER

[In millions of dollars]

Area	Grand total	Private holders						Official holders
		Total	Individuals residing abroad		Other foreign holders			
			U.S. nationals	Foreign nationals	Banks, brokers, and nominees	Investment and insurance companies, etc.	Other business firms	
Total	24,671	23,677	2,245	2,249	13,076	3,653	2,454	994
Europe	17,562	17,453	1,541	1,027	11,023	2,294	1,570	109
Canada	3,580	3,564	225	680	1,386	880	393	16
Latin American Republics	618	618	161	195	13	108	142	(1)
Other Western Hemisphere	904	904	117	72	192	307	218	(1)
Middle East oil exporting countries	518	68	20	26	(1)	1	20	450
Other Asia	913	844	132	210	379	21	102	69
Africa	61	60	20	17	3	16	4	1
Other countries and unallocated	170	169	30	25	84	27	5	1
International organizations	348	(1)	(1)	(1)	(1)	(1)	(1)	348

[1] Less than $500,000 or 0.

TABLE C.—FOREIGN PORTFOLIO INVESTMENT IN STOCKS BY MAJOR INDUSTRY AND TYPE OF FOREIGN HOLDER

[In millions of dollars]

Industries	Grand total	Private holders						Official holders
		Total	Individuals residing abroad		Other foreign holders			
			U.S. nationals	Foreign nationals	Banks, brokers, and nominees	Investment and insurance companies, etc.	Other business firms	
Total	24,671	23,677	2,245	2,249	13,076	3,653	2,454	944
Agriculture, forestry and fishing	23	23	2	7	8	2	4	(1)
Mining	2,284	2,231	139	178	1,234	389	290	53
Construction	262	249	18	23	152	45	11	13
Manufacturing	14,758	14,115	1,213	1,215	8,157	1,958	1,572	643
Transportation and public utilities	2,662	2,564	200	185	1,429	546	203	98
Trade	1,067	983	57	129	469	212	117	84
Finance, insurance and real estate	3,301	3,203	595	440	1,490	441	237	98
Services	279	274	22	69	113	49	21	5
Federal Government	38	38	(1)	2	23	10	2	(1)
State and local governments	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)

[1] Less than $500,000 or 0.

Digitized by Google

TABLE D.—FOREIGN PORTFOLIO INVESTMENTS IN LONG-TERM DEBT OBLIGATIONS BY MAJOR AREA AND FOREIGN HOLDER

[In millions of dollars]

Area	Grand total	Private holders							Official holders
			Individuals residing abroad		Other foreign holders				
		Total	U.S. nationals	Foreign nationals	Banks, brokers, and nominees	Investment and insurance companies, etc.	Other business firms		
Total	42,427	16,050	407	582	12,005	1,906	1,150		26,377
Europe	27,764	12,121	241	302	10,091	941	546		15,643
Canada	4,758	1,452	29	61	345	816	201		3,306
Latin American Republics	353	280	46	94	88	9	43		73
Other Western Hemisphere	867	866	27	12	655	81	91		1
Middle East oil exporting countries	1,580	161	7	2	149	1	1		1,419
Other Asia	4,907	924	43	25	607	23	226		3,983
Africa	23	16	7	3	5	(1)	(1)		7
Other countries and unallocated	253	231	8	82	65	34	41		22
International organizations	1,923	(1)	(1)	(1)	(1)	(1)	(1)		1,923

[1] Less than $500,000 or 0.

TABLE E.—FOREIGN PORTFOLIO INVESTMENT IN LONG-TERM DEBT OBLIGATIONS BY MAJOR INDUSTRY AND TYPE OF HOLDER

[In millions of dollars]

Area	Grand total	Private holders							Official holders
			Individuals residing abroad		Other foreign holders				
		Total	U.S. nationals	Foreign nationals	Banks, brokers, and nominees	Investment and insurance companies, etc.	Other business firms		
Total	42,427	16,050	407	582	12,005	1,906	1,150		26,377
Agriculture, forestry, and fishing	14	12	(1)	(1)	9	2	2		3
Mining	2,185	2,145	3	12	1,768	148	213		40
Construction	61	60	(1)	(1)	50	2	8		1
Manufacturing	8,132	7,969	20	234	6,495	506	713		165
Transportation and public utilities	2,506	2,045	42	18	1,459	453	75		470
Trade	499	489	8	7	389	24	62		10
Finance, insurance, and real estate	2,567	1,792	157	279	1,156	143	58		787
Services	209	207	2	3	197	1	4		2
Federal Government	25,914	1,022	51	13	406	537	15		24,899
State and local government	309	309	124	12	77	94	2		(1)

[1] Less than $500,000 or 0.

Digitized by Google

TABLE F.—CONCENTRATION OF PRIVATE FOREIGN PORTFOLIO INVESTMENTS IN STOCKS, PERCENTAGE OF OWNERSHIP AND MAJOR INDUSTRY

[Amounts in millions of dollars]

Percent of concentration	Total	Mining	Manufacturing	Transportation, and public utilities	Finance insurance and real estate	Other industries
Total:						
Number of companies	5,286	177	2,114	444	1,598	953
Value of foreign-owned voting stock	23,995	2,280	14,610	2,690	2,818	1,596
0 under 2 percent:						
Number of companies	3,303	67	1,169	300	1,214	553
Value of foreign-owned voting stock	2,023	106	667	446	516	288
2 under 4 percent:						
Number of companies	871	33	437	76	169	156
Value of foreign-owned voting stock	6,651	237	4,466	1,154	525	269
4 under 6 percent:						
Number of companies	425	29	216	29	73	78
Value of foreign-owned voting stock	4,744	681	2,960	195	440	468
6 under 8 percent:						
Number of companies	240	20	100	17	50	53
Value of foreign-owned voting stock	2,949	504	1,675	107	429	234
8 under 10 percent:						
Number of companies	119	9	54	4	26	26
Value of foreign-owned voting stock	902	241	364	10	256	31
10 percent and over:						
Number of companies	328	19	138	18	66	87
Value of foreign-owned voting stock	6,726	513	4,478	778	652	305

TABLE G.—PAYMENT OF DIVIDENDS BY MAJOR AREA AND TYPE OF HOLDER BASED ON YEAREND 1974 POSITION

[In millions of dollars]

Area	Grand total	Private holders						Official holders
			Individuals residing abroad		Other foreign persons			
		Total	U.S. nationals	Foreign nationals	Banks, brokers, and nominees	Investment and insurance companies, etc.	Other business firms	
Total	1,579	1,523	107	182	764	350	120	56
Europe	1,019	999	55	48	632	184	79	20
Canada	394	394	12	110	104	148	20	1
Latin American Republics	35	35	14	10	1	4	5	(1)
Other Western Hemisphere	36	36	3	3	10	11	9	(1)
Middle East oil exporting countries	22	4	1	1	(1)	(1)	1	18
Other Asia	42	38	11	7	14	2	5	4
Africa	11	11	8	2	(1)	1	(1)	(1)
Other countries and unallocated	8	8	3	1	3	1	(1)	(1)
International organizations	12	(1)	(1)	(1)	(1)	(1)	(1)	12

[1] Less than $500,000 or 0.

Digitized by Google

TABLE H.—PAYMENT OF INTEREST BY MAJOR AREA AND TYPE OF HOLDER BASED ON YEAREND 1974 POSITION

[In millions of dollars]

Area	Grand total	Private holders: Total	Individuals residing abroad: U.S. nationals	Individuals residing abroad: Foreign nationals	Other foreign holders: Banks, brokers, and nominees	Other foreign holders: Investment and insurance companies, etc.	Other foreign holders: Other business firms	Official holders
Total	3,042	1,331	33	50	1,009	138	101	1,711
Europe	1,962	977	20	24	823	64	46	985
Canada	379	126	3	5	37	61	20	253
Latin American Republics	36	29	4	9	10	1	5	7
Other Western Hemisphere	84	84	2	1	66	6	9	(1)
Middle East oil exporting countries	125	14	(1)	(1)	14	(1)	(1)	111
Other Asia	339	77	4	3	53	3	16	262
Africa	1	1	(1)	(1)	(1)	(1)	(1)	(1)
Other countries and unallocated	23	23	(1)	8	6	3	5	(1)
International organizations	93	(1)	(1)	(1)	(1)	(1)	(1)	93

[1] Less than $500,000 or 0.

INVESTMENTS AFTER 1974

A substantial amount of foreign portfolio investment in the United States was made in 1975 and early 1976, particularly in U.S. stocks. Net foreign purchases of U.S. stocks totaled $4.4 billion, in 1975 and $0.8 billion in January and February of 1976.

The increasing interest of the oil-producing countries in U.S. equities was evident in these figures as those countries accounted for a third of the total inflow. Practically all of the remainder was accounted for by the same countries which have been the major purchasers of U.S. equities in the past, Canada and a few European countries. Germany emerged as a major purchaser of U.S. stocks for the first time in several years, accounting for $0.4 million of the inflow in the fourteen-month period through February, 1976.

The total of $4.4 billion for 1975 was a record high but it was probably affected by the unusually small inflow in 1974 when market prices were declining and net foreign purchases of U.S. stocks were only $0.5 billion. When 1974 and 1975 are taken toegther it is seen that the total inflow for these two years was no greater than the total for 1972 and 1973.

The figures for 1974 and 1975 respectively follow the overall trend in buyer interest in the U.S. stock market, i.e., quite weak in 1974 and strongly recovering in 1975. Past experience indicates that foreigners generally follow overall trends in the U.S. stock market sometimes with a lag.

It should also be noted that purchases by European residents in 1974–1975 were considerably less than in 1972–1973. While the oil-producing countries are obviously an important new element in foreign demand for U.S. stocks, it remains to be seen whether purchases by these countries will continue to match their purchases of 1975 and early 1976, some of which probably represented one-time shifts from short-term to long-term investments in the United States.

The value of foreign holdings of U.S. stocks was also substantially increased by the sharp recovery in U.S. stock prices in 1975. The addition to the value of these holdings on account of price increases is estimated at $8.1 billion for 1975, which, along with the net inflow of $4.4 billion, raised the total of foreign investment in U.S. stocks to about $37 billion by the end of the year.

Digitized by Google

The relative lack of foreign interest in U.S. corporate bonds continued to be evident in 1975 and early 1976. Middle Eastern oil-producing countries purchased $1.4 billion of these instruments in 1975, but as in the case of their purchases of U.S. stocks, this may have been mostly a one-time shift in order to balance out the U.S. portfolios of these countries with more long-term assets. International institutions redeemed or sold off $1 billion of U.S. corporate bonds in 1975 and the net purchases of all other countries were about $0.2 billion.

As noted elsewhere in this report, foreign interest in U.S. corporate bonds has never been significant, except during the mid-sixties and early seventies when U.S. Government balance-of-payments programs caused U.S. companies to actively sell Euro-bonds at more attractive interest rates to foreigners. With the ending of these programs in early 1974, U.S. corporate bonds appear to be returning to their previous position as relatively unimportant in the U.S. portfolio of foreigners.

The dominance of U.S. stocks in this portfolio is seen in the estimates of the total amounts outstanding for foreign portfolio investment in the United States as of the end of 1975. These estimates are based on the 1974 survey and our monthly data on foreign portfolio transactions plus estimates of the changes in market values of foreign-held securities.

	Amount (billions)	Percent
Stocks	$37.2	43
Corporate bonds [1]	11.1	13
Other private debt	8.3	10
U.S. Treasury debt	29.4	34
Total	86.0	100

[1] Includes issues of Federal agencies and State and municipal governments.

When account is taken of the special factors involved in foreign holdings of U.S. corporate bonds noted above and of the fact that U.S. Government bonds are mostly held by foreign official institutions for international reserve purposes, it is seen that U.S. stocks still have the predominant role in private foreign portfolio investments in this country.

TABLE I.—FOREIGN PORTFOLIO INVESTMENTS IN U.S. STOCKS AS OF DEC. 31, 1974, AND CALCULATED VALUES FOR DEC. 31, 1975

[In millions of dollars]

Area	Market value as of Dec. 31, 1974	Addition due to change in market value	Net foreign purchases of stocks [1]	Estimated market value as of Dec. 31, 1975
Total	24,671	8,119	4,435	37,225
Europe	17,562	5,770	2,475	25,796
Canada	3,580	1,166	357	5,103
Latin American Republics	618	199	9	825
Other Western Hemisphere	904	288	−16	1,176
Middle East oil exporting countries	518	209	1,441	2,168
Other Asia	913	297	141	1,352
Africa	61	20	6	86
Other countries and unallocated	170	56	14	240
International organizations	348	114	18	480

[1] Adjusted to eliminate security transactions related to direct investments.

Digitized by Google

TABLE J.—FOREIGN PORTFOLIO INVESTMENTS IN CORPORATE BONDS AS OF DEC. 31, 1974 AND CALCULATED VALUES FOR DEC. 31, 1975

[In millions of dollars]

Area	Value as of Dec. 31, 1974 [1]	Addition due to change in market value [2]	Net foreign purchases	Estimated market value as of Dec. 31, 1975
Total	10,275	142	671	11,088
Europe	7,126	116	116	7,358
Canada	779	14	126	919
Latin American Republics	46	1	28	75
Other Western Hemisphere	227	4	3	234
Middle East oil exporting countries	745	6	1,427	2,179
Other Asia; Africa; Other countries and unallocated; International organizations	1,351	1	−1,027	322

[1] Marketable securities are carried at market value; all other long-term debt is carried at face or stated amounts.
[2] Adjustment is made only for marketable securities; other long-term debt is carried at face value.

Note: Data include transactions in issues of States and municipalities and of corporations and other agencies of the U.S. Government.

ECONOMIC FACTORS RELATING TO FOREIGN PORTFOLIO INVESTMENT IN THE UNITED STATES

The second major task of the Treasury Department under the Study Act was to research the reasons for foreign portfolio investment in the United States and the processes, mechanisms and financing methods related thereto. The following findings in these areas are based primarily on interviews by a private research firm with bankers, brokers and others active in foreign portfolio investment in the United States and in selected foreign countries.

Why Foreigners Invest in U.S. Securities

Expectations for long-term capital growth.—A large majority of foreign portfolio managers cited "long-term capital gains" as the major objective of investments in the United States. The term itself has undergone some changes in meaning over the past ten years. In the mid-sixties, for example, long-term capital growth referred to the strategy of buying stock in companies whose earnings were expected to grow and holding on to those stocks until this growth was reflected in the value of the stocks. More recently, foreign portfolio investors—like those at home—have come to realize that long-term capital gains positions could be eroded by failure to recognize in time abrupt changes occurring in the fundamental characteristics of the investee company, its industry, or even country. Consequently, it was reported, investment strategies have been altered to take short-term profits in particular securities when they occur, while nonetheless preserving the objective of long-term capital growth of funds. The fact that many foreign governments do not tax capital gains undoubtedly encourages such strategies. Some evidence of this view may be found in the fact that the turnover of foreign portfolios of U.S. stocks seems to be somewhat faster than the turnover of all stocks listed on the New York Stock Exchange.

Relative economic and political stability of the United States.—Unlike their U.S. counterparts, international portfolio managers must first decide the "currency" (or country) in which to invest. This decision requires an assessment of international economic and monetary developments, as well as of relative political stability.

The United States is popular with foreign portfolio managers in large measure because of its relative political stability. Many European investors see the United States as more sympathetic to free enterprise and the profit motive than some other major countries, with less risk of nationalization of private enterprise.

Digitized by Google

There was also frequent expression of the view that the U.S. economy was less vulnerable to cyclical influences than some other countries. The question of exchange rate risk was frequently raised; while many respondents seemed to regard the present system of flexible rates as adding a new hazard, there was no evidence that the new system was deterring portfolio investment in the United States.

The size and liquidity of U.S. capital markets.—The relatively small size of many foreign economies in relation to their stock of accumulated savings, and the fact that in many countries business investment is financed extensively by bank credit, closely held stock issues, and government funds, combine to limit domestic opportunities for portfolio investment. The lack of depth and liquidity associated with smaller capital markets abroad also makes it difficult to place large amounts of funds in a relatively short period of time. In short, there is a seasoned secondary market for securities in the U.S. markets that frequently does not exist elsewhere.

Organization and regulation of U.S. capital markets.—Many foreign investors cited the regulation of the U.S. securities markets (mainly by the Securities and Exchange Commission) as a strong attraction to foreign investment. Other investors noted that the U.S. markets are better organized than many others; that is, the mechanisms for initiating and concluding a trade are more systematic, occur promptly, and specialists act to maintain orderly markets.

Great range of investment choices.—Many foreign portfolio managers invest in the United States to participate in industries that simply do not exist locally, or in other foreign countries. Most high technology industries, such as computer, communications, and aerospace, are concentrated in the United States. Foreign investors are also attracted to the natural resources of the United States, such as oil, gas and timber.

Finally, in some foreign countries, the choice of issues is limited because the local government is in charge of many sectors of economic activity; for instance, to invest in airlines, railroads or even utilities, it may be necessary to invest in the United States. The U.S. markets are also unique in offering a large variety of instruments such as warrants, options, rights, and convertible debentures.

Sales efforts of U.S. securities dealers.—The U.S. securities industry makes a strong effort to sell U.S. securities abroad. Most large broker/dealers provide the same kinds of advice and services to their foreign clients as to their domestic accounts, and have established branch offices in major foreign cities to serve foreign clients (as well as to engage in underwriting of issues, notably Euro-issues, abroad).

Although many foreign investors reported having suffered losses in the late sixties and early seventies following the recommendations of salesmen for U.S. broker/dealers, they still continue to purchase securities through firms in which they have confidence. In effect, the "salesmen" are the analysts, economists and investment managers who combine to produce reliable recommendations.

In addition, U.S. corporate executives travel abroad regularly to address investor groups, to keep them informed of developments in their respective companies. Foreign investors are also "sold" U.S. securities by their own local brokers, particularly those who may have participated in foreign underwriting of U.S. issues.

The greater efficiency of U.S. markets.—U.S. security markets are widely considered to be the most efficient in the world, in the sense that information is widely available and almost instantaneously reflected in the prices of stocks. This means that even inside information is no guarantee of consistent returns in excess of those earned by the market as a whole.

Some investors view the efficiency of U.S. markets as a reason for not investing in the United States; most, however, consider efficiency to be a positive factor. The former say they can make good profits only on markets where manipulation is common. The latter say that the full disclosure of accounting information required in the United States provides a broader knowledge of the companies in which to invest. By contrast, non-U.S. companies that are listed only in foreign markets often provide very limited information. The information that is provided is often poorly presented, incomplete and sometimes deliberately misleading.

Other Economic Factors

The outlook for the U.S. business cycle is obviously one consideration for potential foreign investors in the United States and they seem to be avid con-

Digitized by Google

sumers of U.S. economic projections. However, the prevailing opinion among persons interviewed was that most foreign investors take a long view, that they are not trying to profit from short-term market swings.

Actual and anticipated exchange rate changes may alter at least the timing of portfolio investment, and countries subject to frequent or violent rate changes may lose even their longer term attractiveness to foreign investors. Some respondents expressed the view that flexible exchange rate may induce some investors to avoid exchange risk by investing locally. Some investors attempt to hedge against exchange fluctuations, but this is usually not practicable for relatively long periods of time, and besides may be costly enough to wipe out anticipated gains on the investment itself.

Relative interest rates among countries at any particular time, and current interest rates in the United States compared to those prevailing in the past or expected to prevail in the future, will obviously affect the timing, and perhaps the absolute volume, of private foreign investment in U.S. debt issues.

Changes in foreign exchange controls abroad obviously have a considerable effect on foreign portfolio investment in the United States. Most countries maintain *de jure*, if not always *de facto*, controls on outward capital movements; among the major countries, Canada, Switzerland, and Germany are outstanding exceptions.

Changes in the amount of real foreign capital available for outside investment, as indicated by balance-of-payments surpluses, will also affect portfolio investment in the United States. Variations among foreign countries in the share of world savings may also have an effect, since some countries (e.g. Canada), have a higher propensity than others for placing externally invested funds in the United States

Foreign portfolio investors use the same investment channels, for the most part, as do U.S. portfolio managers. For equities, these channels are, in relative order of size, the New York and American Stock Exchanges, regional exchanges, the over-the-counter market and foreign exchanges which list U.S. securities.

Foreign investors use U.S. brokers, U.S. subsidiaries of foreign firms, and, when dealing on an overseas exchange, the stock exchange departments (or trading desks) of foreign banks. The point was made by some U.S. subsidiaries of foreign banks that, although they had originally been created to serve as a captive vehicle to reduce commission expenses for their parents, they had become independent brokerage firms competing with U.S. brokers for the same clients.

With the trend towards increasing independence by the formerly "captive" subsidiaries, more brokerage business is again being directed by foreign portfolio managers to U.S. brokers. The type of brokerage firm used is typically one which has good research facilities, will service overseas accounts well, and has execution expertise.

Some foreign portfolio managers will enter all orders to buy and sell listed securities to the New York Stock Exchange, while others use local exchanges. The number of U.S. securities listed on foreign exchanges varies, but will usually include the major U.S. corporations, as well as multinationals doing business in the host foreign country. In Switzerland, for example, a Swiss bank will often "sponsor" a U.S. company, and will then be responsible for maintaining a reasonable market in that company's stock.

In selecting brokers, foreign investors attach considerable importance to research capability and quality of investment ideas. Another important factor is the U.S. broker's ability to invite the foreign bank concerned into key underwritings.

To a greater extent than their U.S. counterparts, most foreign portfolio managers agree to place a certain volume of business with a U.S. broker in exchange for access to the firm's research capability. The complexity of these arrangements has caused most foreign institutional portfolio managers to use the services of a relatively small number of U.S. brokers.

Since almost all foreign investors are dependent on U.S. brokers for research and other information on U.S. companies, the foreign investors are not as commission conscious as their U.S. counterparts. While they expect a reduction from the fixed rates of pre-May 1, 1975, most indicated that they do not seek the lowest possible cost. Some foreign investors also expressed concern that the competitive commission structure would result in a significant reduction in the amount of investment research that U.S. brokers provide; their comments reflect their dependence upon U.S. brokers for such information.

Digitized by Google

In recent years Eurodollar bonds have been the most frequently used vehicle for foreign investment in U.S. bonds. The mechanism normally used is for the foreign bank to join the underwriting group, if possible, and then to sell to its own clients directly. Less frequently, the foreign portfolio manager will purchase these securities from U.S. or foreign underwriters of these issues.

Few foreign investors purchase domestically issued U.S. corporate debt obligations. However, some Canadian and U.K. insurance companies maintain a portfolio expert in the United States to facilitate participation in original underwritings.

With rare exceptions, foreign portfolio investment is not "financed" by borrowing, either in the United States or abroad. At the end of 1974, for instance, U.S. brokers reported only $200 million "due from foreigners," an amount that was actually exceeded by the $300 million due to foreigners. U.S. brokers, banks and other lenders are, of course, subject to Federal controls on margin requirements with respect to their foreign as well as their U.S. customers.

There are two apparent exceptions to this, which on closer examination prove not to be typical. First, British investors have from time to time engaged in what are called "loan fund" operations. These funds are explicitly set up to avoid the effects of U.K. exchange regulations, and involve the use of "back-to-back" loans to obtain the foreign currency necessary to purchase foreign assets, in effect by-passing the "investment dollar" pool with its attendant premium.

The second exception is that, from time to time, foreigners have placed the proceeds of U.S. borrowings in U.S. assets during the period between take-down of the proceeds and actual expenditure of funds. This has been particularly true of the largest borrowers—international organizations and Canadian entities. Indeed, it was for some years U.S. policy to strongly encourage such actions.

EFFECTS OF U.S. ECONOMY AND BALANCE OF PAYMENTS

As a general proposition, foreign portfolio investment is beneficial to the U.S. economy in the same way as other economic transactions between residents of the United States and foreign residents are beneficial to our economy. All economic transactions which are motivated by market forces are presumed to be beneficial to the economy as a whole, and transactions in U.S. securities between foreigners and U.S. residents are no different in this respect than any other kind of transaction between Americans or between Americans and foreigners.

Foreign portfolio investments in the United States are frequently termed as "inflows of foreign capital" and as such are sometimes viewed as additions to the U.S. pool of capital for investments. While foreign portfolio investment does benefit the capital investment process in the United States, it does not involve an inflow of capital in the real sense. The term "inflow" can also be misleading in the financial sense when applied to foreign portfolio investments since the process may involve nothing more than a change in the form of U.S. liabilities to foreigners.

To understand the process, it is useful to work through a typical foreign portfolio investment in the United States. When a foreigner buys a U.S. security he will usually buy it through a U.S. broker with dollars, which he will either have on deposit in a U.S. bank or acquire from some other foreigner (e.g., a bank) who has dollar deposits in the U.S. Thus far, the transaction is no different in its effect on the economy than a similar purchase by a U.S. resident, and the only effect on the U.S. international investment position—our balance sheet vis-a-vis foreigners—is an increase in our liabilities to one foreigner (the buyer of the security) and an equivalent decrease in our liabilities to another foreigner (the foreign bank). If the supplier of dollars (who may be the investor) does not replenish his inventory, the transaction is merely a "paper transfer" with no immediate effect on the balance of payments abroad. The effect of foreign transactions in U.S. securities in the aggregate on the capital investment process in the United States is significant, however.

Many different investors and intermediaries play important roles in the process of transmitting funds from savers to the ultimate users of capital, those who actually undertake the investments in "bricks and mortar." Portfolio investors are obviously a major source of capital for this purpose. Most portfolio investors do not, of course, inject capital directly into U.S. firms since the bulk of securities bought and sold are outstanding issues which are traded among portfolio investors. Nevertheless, the participation of investors in this secondary market helps to make the market for new issues. First, it supplies funds to those

Digitized by Google

investors who may want to exchange their holdings of outstanding securities for new issues. Secondly, the knowledge that a new issue bought today can be later sold in a market which is broad and active enough to develop a good demand and fair price for the issue will make investors more inclined to invest in new issues.

Foreigners who participate in the U.S. capital market as portfolio investors serve these purposes in the same manner as U.S. portfolio investors. They add to the breadth and efficiency of the market and, to some extent, bring a new dimension to the market, i.e., proclivities for some kinds of issues which may not be common to U.S. investors.

From the standpoint of U.S. Government policy, the question of whether and to what extent foreign portfolio investment benefits the U.S. economy is meaningful only if we ask, as compared to what? That is, if Government measures were taken to either restrict or encourage foreign portfolio investment here, what would the effect be on the economy?

If restrictions were imposed on this investment the benefits noted above would be lost or diminished. The foreign-held funds which would otherwise have gone into long-term U.S. securities would be held instead in short-term dollar investments such as bank C.D.'s and Treasury bills or foreign investments and/or, as a result of a weaker dollar in international exchange markets, be spent for U.S. goods and services.

There is no presumption that the use of foreign funds for these purposes is any less (or more) beneficial to the U.S. economy than using them to acquire U.S. stocks and bonds, if they are the result of market forces. However, if special incentives or disincentives are given to guide these funds away from one use into other uses, the market test breaks down and there is no guide as to whether the funds are being allocated in the most economically efficient manner. In other words, there is no economic basis for judging that certain kinds of transactions with foreigners are "good" for the economy and that others are "bad", any more than for such judgments on particular kinds of domestic transactions.

Balance-of-Payments Effects

To the extent that foreign portfolio investment represents a demand for U.S. rather than foreign liabilities (as opposed to a demand for U.S. portfolio instruments rather than liquid dollar liabilities) it will tend to increase the value of the dollar in foreign exchange markets if exchange rates are reasonable free to fluctuate. If exchange rates are relatively fixed, portfolio investment is likely to be offset by official reserve movements. That is, foreign central banks either will lose official reserves (sell U.S. Government securities) or acquire fewer U.S. Government securities than they would have otherwise.

Under the present system of reasonably flexible exchange rates, the effect of a large and continuous flow of capital in one direction—say large foreign purchases of U.S. securities over a considerable period of time—would tend to affect trade and other current account items more quickly than under a system of fixed rates. This is because the resulting effect on exchange rates will change price relationships between U.S. and foreign goods, with an impact on both exports and imports. Even under flexible rates, however, the most immediate impact is likely to be on other capital items; changes in trade patterns require adjustments in production and distribution channels which cannot be instantaneously effected.

A shift in foreign portfolio preferences in favor of U.S. rather than foreign instruments would thus have complex effects both on other capital transactions and transactions on current account. In the very short run, such a shift might lead to a mild speculative flurry in favor of the dollar and a drawdown in foreign official reserves if foreign central banks maintain a policy of active intervention in support of exchange rate targets. In the longer-run, this shift would result in some increase in the quantity of real imports available to the United States at an exchange rate not influenced by intervention policy.

Foreign acquisition of U.S. securities does, of course, give rise to outflows of funds in the form of dividends and interest. These outflows are payments for "value received" (the U.S. use of foreign financial capital) and are thus strictly analogous to payments for the import of real goods and services. In this connection it should be remembered that foreign transactions in U.S. securities involve foreign payments to U.S. providers of financial services. It is estimated that in 1975 over $200 million of commissions were received by U.S. brokers

Digitized by Google

from foreigners for transactions in U.S. stocks. An additional sum was paid for bond transactions.

In summary, under present institutional arrangements, flows of foreign portfolio capital do not affect the overall "surplus" or "deficit" in the balance of payments as in the pre-1973 period, but they can, and probably do, have a larger impact on other private international transactions, both in the capital and current accounts, than before.

International Investment Position

As noted earlier, foreign portfolio investment in the United States, in the first instance, affects only the composition of our international investment, not the overall creditor position of the United States. Our net international investment position can only be affected by movements of goods and services, in balance of payment terms, by current account surpluses or deficits. These investments can, however, indirectly affect the current account over time, but the effects are somewhat ambiguous.

Under fixed exchange rates, as already indicated, a movement of private capital in one direction was apt to be offset, at least in the short run, by movements of official capital in the opposite direction. Even under flexible rates, an autonomous movement of capital is apt to induce in the short run offsetting movements of other forms of capital, with no net effect on the overall investment position of the country. However, under flexible exchange rates, the possibility that sustained capital flow in one direction will affect the current account of the balance of payments in the opposite direction is, as just stated, more likely than under fixed rates. Thus, an inflow of foreign capital would now tend, more than formerly, to change the international investment position of the United States, that is, to increase foreign investment here relative to U.S. investment abroad.

Effects on Financial Markets

The effect of foreign portfolio investment on U.S. financial markets may be discussed in somewhat the same terms as the effects on the balance of payments. Any additional demand for securities in any segment of a capital market tends to raise prices and reduce yields on the type of securities demanded. Thus, foreign purchases of U.S. stocks and bonds have a tendency to reduce yields and therefore make raising of capital relatively easier for domestic borrowers. This in turn will tend to stimulate real investment and increase the output and productivity of the economy.

In fact, foreign portfolio capital inflows are relatively small in relation to total capital formation in the U.S. economy, which makes it difficult, if not impossible, to measure any such effects statistically. However, it seems quite likely that they have some impact on the structure of capital markets in the United States. Since foreign investors limit themselves mainly to securities of fairly well known corporations, the result is presumably to reduce the cost of capital to those sectors relying on those forms of financing. However, arbitrage among various sectors of the capital markets is probably sufficiently efficient to ensure that any increase in the flow of funds to one market sector will have a tendency to ease conditions in all sectors, although relatively more so in the sectors where the new funds are immediately injected.

Gross transactions of foreigners in U.S. stocks tend to be somewhat larger as a proportion of their total holdings of U.S. stocks than is the case with American investors. On the other hand, while foreign purchases have tended to move with the market—rising in strong markets and declining in weak markets—on the whole they have lagged behind U.S. investors in this respect. More importantly, foreigners as a whole have been net purchasers of U.S. stocks in every year since 1957, except for the years 1964–1966. Thus, foreigners have on balance tended to strengthen U.S. stock prices.

In this connection it should be noted that the figures on net foreign acquisitions of U.S. securities are the result of much larger gross purchases and gross sales. For example, net foreign acquisitions of U.S. stocks in 1974 of only $0.5 billion reflected gross purchases of $7.6 billion and gross sales of $7.1 billion, and in 1975 the net acquisitions of $4.4 billion reflected purchases of $15.0 billion and sales of $10.6 billion. Thus, foreigners' gross transactions in stocks in 1975 were equivalent in value to their total holdings as of the end of 1974. The impact of foreign participation in U.S. securities markets, therefore, is considerably larger than indicated by their total holdings or by their net purchases.

Digitized by Google

In any case, it is clear that foreigners add to the depth and resiliency of the market. If, in the same process, they may also add somewhat to its volatility, the latter effect may be regarded as a small cost for the larger benefits resulting from foreign participation.

EFFECTS OF U.S. LAWS

While there is very little in the way of U.S. legislation designed to affect the volume or type of foreign portfolio investments in the United States, these investments are affected by various laws drawn up for other purposes. In some cases these laws undoubtedly deter some foreigners from investing in the United States; in other cases, the law may be viewed as a positive factor. It is not possible, however, to judge objectively the extent of these effects; in this section we can only report on the likely effects of certain laws (i.e., to increase or decrease investment), as perceived by persons in the banking, legal and brokerage communities in the United States and abroad.

Tax Laws

Withholding tax.—U.S. Federal tax law specifies that a foreign person (either a nonresident alien individual or a foreign corporation) will be taxed at a statutory withholding rate of 30 percent on his passive investment income other than capital gains. If the foreign person is a resident of a country that has a tax treaty with the United States, the tax on such passive investment income is normally lower, e.g., 15 percent on dividends, 0 percent on interest. Capital gains classified as passive investment income accruing to foreigners are not taxed by the United States.

The withholding tax is considered a substantial deterrent to foreign portfolio investors considering investments in income-oriented equities and debt issues. The U.S. banking and brokerage communities feel strongly that they are at a distinct competitive disadvantage in offering management and brokerage services in these areas. There has been so little foreign investor interest in this area that many brokers have discontinued sending investment information on fixed income securities to their foreign offices. Rumors of the United States terminating the withholding tax has stimulated inquiries as to U.S. brokerage capabilities on fixed income securities orders.

In the case of growth-oriented, low-yielding, equity issues, foreign investors view the withholding tax as a cost of doing business or as a sales tax item which must be paid in order to participate in the U.S. growth equity market. The main objectives of investors in making commitments in growth equities are capital preservation and appreciation. Accordingly, the withholding tax reducing the investors' yield is an acceptable price to pay to achieve these objectives.

The lower treaty tax rates imposed on investment income of foreign investors of various treaty countries have encouraged foreign portfolio investment in the United States for two reasons. First, they generally mitigate the effect of the withholding tax on securities yields by reducing or, in some cases, eliminating the tax on various classes of income. In addition, the treaties frequently provide that the tax paid to the United States on dividends or interest can be offset as a credit against the tax payable by the foreign investor to his home country. Second, treaties providing for reduced withholding rates induce foreign investors of countries without treaties with the United States to form either personal holding companies or trusts in the foreign treaty jurisdiction in order to have their investments in the United States receive favorable withholding tax treatment. These entities are then afforded the benefit of treaty tax rates applicable to the jurisdictions in which they are operating.

On the other hand, treaties negotiated between the United States and other countries have provisions requiring both countries to exchange information necessary to carry out the tax law of each country and these provisions have deterred foreign investors who are sensitive to information on their financial assets being given to their home governments. Accordingly, these investors have either been deterred from investing in the United States entirely or have employed indirect devices or foreign institutions to make their investments in the United States, such as foreign trusts and personal holding companies, formed in tax haven jurisdictions. In certain cases, it is alleged that the fear of disclosure is so strong that foreign investors who are suspected of being residents of treaty countries claim to be residents of non-treaty countries, thus incurring a higher rate of tax, but avoiding disclosure to their home governments.

Digitized by Google

The effect of the withholding tax on foreign portfolio investment, as seen in the brokerage community, is the encouraging of speculation rather than sound investment analyses. The reduction of yields due to the withholding tax encourages the foreign investor who is exempt from capital gains taxes to look to short swing profits in both the equity and debt securities markets. The result is rapid turnover of foreign portfolios.

The banking community has observed that the foreign investor portfolios are deprived of full servicing in the American securities market due to the withholding tax. The portfolio manager is limited to certificates of deposit or foreign dollar securities to achieve the required yields on dollar securities for accounts for which income is a primary investment objective. Accordingly, the account is deprived of participating in U.S. Government and U.S. corporate debt issues to achieve its objectives.

The withholding tax collection burden imposed on U.S. institutions and foreign institutions in cases of treaty obligations is regarded as a deterrent in soliciting foreign portfolio accounts. Specifically, the cost of collection and payment of the tax is a factor in establishing fees for foreign accounts and acts as a deterrent in evaluating whether this line of business should be sought after by U.S. institutions. Similarly, foreign institutions which must act as collection agents for the United States under a treaty obligation in accounts where their foreign investor client is not entitled to the treaty rate applicable to the country where the financial institution is resident (e.g., Colombian client of a Swiss bank) are deterred by the cost of collection and recordkeeping from recommending more investment in U.S. securities.

Estate and Gift Tax

Federal tax law imposes an estate tax on a foreign investor's property situated or deemed to be situated in the United States. For estate tax purposes, United States corporate securities, no matter where the certificates are located, are deemed to be part of a nonresident alien's gross estate. Foreign corporate securities are, of course, excluded from a foreign investor's U.S. estate. The law provides for a $30,000 exemption and a 5 percent tax on the first $100,000 of an estate. The highest rate of tax is 25 percent applied to that part of an estate that exceeds $2,000,000.

Estate tax treaties modify the estate tax rules (e.g., for purposes of determining the status of certain kinds of securities and bank deposits). There is statutory authority for the President to impose a more burdensome estate tax on citizens of countries whose governments impose burdensome estate taxes on U.S. citizens who have property in those countries. Shares of a foreign personal holding company that is completely owned by foreign persons and which in turn holds U.S. securities are not subject to U.S. estate taxes.

The United States exempts gifts of intangible personal property by nonresident aliens from the gift tax. Gifts of real estate and tangible personal property located within the United States are subject to the U.S. gift tax. These rules, however, may be modified by treaty.

Imposition of an estate tax on estates of nonresident aliens has deterred portfolio investors with $100,000 to $400,000 from investing directly in the United States by opening accounts with U.S. financial institutions. The U.S. institutions receive many inquires from this size investor who are deterred from opening accounts once they learn of the existence of the U.S. estate tax and the U.S. institutions' obligation to act as statutory executor and comply with the payment of the tax. It is believed this type of capital is either deterred completely from investment in U.S. securities or is channeled to foreign intermediary institutions which do not comply with payment of the U.S. estate tax.

Large foreign portfolio investors tend to use personal holding companies to avoid the imposition of the U.S. estate tax. Under current law, the shares of such companies, if held by nonresident aliens, are exempt from the U.S. estate tax, thus the use of this indirect device merely increases the cost and administrative burden of investing in the United States. The personal holding companies are normally incorporated in tax haven jurisdictions. In some instances, large investors simply utilize foreign banking institutions to avoid payments of the estate tax. The capital is merely transferred from the decedent's account to a new account for the heirs without payment of the U.S. estate tax.

The attitude of many foreign investors is that the U.S. estate tax is a foolish tax and can be easily avoided.

Digitized by Google

Accordingly, there is a great deal of intentional non-compliance by placing funds in foreign banking institutions. In addition, there is a genuine lack of awareness of the tax and thus non-compliance for that reason.

It is generally felt by banks and brokers that the existence of the estate tax has encouraged tremendous amounts of capital to be placed offshore with foreign financial institutions rather than U.S. institutions which have the obligation to ensure that all estate taxes on foreign investors' accounts are paid, at least to the extent of the property in the account. Accordingly, U.S. financial institutions are at a competitive disadvantage with their foreign counterparts which have no legal liability to ensure compliance.

There is some concern among foreign investors that overly aggressive tax authorities will seek to tax the foreign investor's entire estate, although he is a non-resident alien subject to tax only on U.S. securities and other property located within the United States. The fear stems from cases where the U.S. Government has alleged that U.S. citizens who have attempted to renounce their citizenship have failed to do so effectively and therefore are still, as citizens, subject to tax on their entire worldwide estate. However, irrational the fear is, it has encouraged investment through indirect means (foreign trusts, Swiss banks, etc.) to avoid the imposition of any tax.

The exemption from the gift tax of gifts of intangible property such as portfolio investments, apparently has not affected portfolio investment in the United States one way or the other. In most cases, foreign investors are not aware of our gift tax. There is general agreement that the present rules should be maintained in the interest of maintaining an unrestricted environment for foreign capital.

U.S. Securities Law

Remedies and protections provided to foreign investors under U.S. laws.—The provisions of U.S. securities law requiring substantial disclosure of material information in U.S. registered public offerings and provisions against fraudulent practices in unregistered offerings are effective in inspiring confidence in the U.S. securities markets. The foreign investor has the overall feeling that our laws provide a more efficient, fairer market place for public offerings. In addition, the rules of fair practices imposed on the brokerage community, are very effective in encouraging foreign investors to take a positive view of the purchase of U.S. securities.

Availability of information.—U.S. securities laws requiring issuers listed on major stock exchanges and many over-the-counter issuers to file public reports as to their financial condition are regarded as a real selling point for U.S. securities. Sophisticated foreign investors and large foreign institutional buyers of American securities are aware of these requirements and utilize such information in their investment decisions. The requirement for prompt disclosure of any important development which may affect the value of securities is also generally regarded positively. The entire trend of disclosure to shareholders through proxy solicitations, annual reports, etc., is effective in encouraging foreign investments in U.S. securities. Foreign investors have expressed a fear of investments in closely held corporations which are not subject to disclosure requirements. The concern is that abuses of private owners would not be discovered until after the investment is made.

Disclosure of ownership rules.—U.S. securities law, Federal regulatory agencies, and state laws have requirements in various degrees as to disclosure of beneficial ownership of stockholders. These requirements are said to be a substantial deterrent to investment in the U.S. securities market because there is a great fear on the part of many foreign investors of having their names on reports filed with the U.S. Government since it could, they fear, lead to reporting to their home government, with unfortunate consequences for them.

There is also a difference in the foreign investor's regard for privacy, as opposed to that of the U.S. investor. Foreign investors regard their financial affairs as their own business and no one else's, including any government authority. The entire history of public reporting has been different abroad than in the United States. U.S. laws and attitudes on disclosure are believed to have led to substantial foreign capital being invested in the United States through indirect means. Specifically, large foreign investors use foreign personal holding companies, foreign trusts, and Swiss banks to channel their capital into the U.S.

Digitized by Google

securities market and preserve their anonymity. U.S. financial institutions are thus deprived of managing large amounts of foreign capital.

Liabilities under U.S. securities law.—Liability under U.S. securities law for insider trading, manipulative practices, violations of resale restrctions, fraud, etc., is generally not a deterrent to the pure foreign portfolio investor. The general feeling is that foreign portfolio investors regard these provisions of U.S. laws as positive factors in regulating our securities markets. There is some concern among foreign investors about innocent violations of U.S. securities law due to unawareness and complexity of U.S. laws. There is also some feeling that the criminal penalties outlined for violations deter some foreign investment. However, in general, foreign portfolio investors have accepted our laws with respect to liability and regard them as a positive factor in the overall regulation of the U.S. securities market.

Credit restrictions.—There is general agreement in the financial community that U.S. securities law restricting credit for the purchase of securities is not a factor in limiting or encouraging foreign portfolio investment in the United States. The universal experience in the financial community is that foreign portfolio investors bring their unencumbered capital to the U.S. markets for investment. They do not require credit, at least not from U.S. sources, prior to entry into the U.S. securities market.

Bank secrecy law.—The Currency and Foreign Transactions Reporting Act—the "Bank Secrecy Act"—provides for reporting and recordkeeping requirements on transactions in currency of more than $10,000 per single transaction effected through U.S. financial institutions. The Act requires the collection of data on the movement of money through domestic financial institutions and of currency and monetary instruments amounting to more than $5,000 in one transaction across the borders of the United States. Accordingly, transactions by foreign investors with or through U.S. financial institutions may be subject to disclosure and reports of such transactions may be required under the provisions of Treasury regulations issued under the Act.

This law has projected a negative image of U.S. banking practice to the foreign investor. Foreign investors are warned by foreign money managers not to place deposits in foreign branches of U.S. banking institutions due to the risk of disclosure. They are also warned that securities with U.S. banks or brokers will be reported to the U.S. Government who, in turn, will—if asked—disclose such assets to the investors' home governments.

There is concern on the part of U.S. banking officials that they will violate foreign secrecy laws if they are compelled to disclose records maintained by foreign subsidiaries. Specifically, if the U.S. bank secrecy law is construed to require such disclosure, foreign affiliates of U.S. companies will be in danger of violating their host countries' secrecy laws. This apparent threat is of concern to foreign investors and clients doing business with foreign affiliates and has deterred business from them.

In the actual administration of the Act, there have been requests for information from foreign governments filed pursuant to the act. The decisions to disclose this information are within the discretion of the Treasury Department and, thus far, such requests have been denied. However, the mere possibility of disclosure to foreign governments has acted as a deterrent to foreign investment in the United States.

Other laws.—Various U.S. laws limit the amount of foreign stockholdings in certain U.S. industries. However, the restrictions which are based on percentage limitations are in all cases well above the percentage of a U.S. company's stock which foreign portfolio investors are inclined to buy. Thus, these laws have not deterred foreign portfolio investment here.

Foreign portfolio investors believe the U.S. compares very favorably with other countries in regard to confiscation. Sophisticated foreign investors are well aware of the provision of the Trading with the Enemy Act but have concluded that the U.S. Government will not arbitrarily expropriate their property. Foreign investors believe that the United States has a system of economic due process which sets limits on what government power can do with regard to expropriation. There is a strong feeling among foreign investors that the United States is one of the last bastions of capitalism and that private property is sacred.

There is, however, concern among foreign investors who have experienced freezing of assets during the Second World War, e.g., German and Japanese in-

Digitized by Google

vestors. In addition, there is some concern among Arab investors due to the controversies arising out of the oil crisis.

As of the present time, the feeling in the financial community is that they can sell the United States to their clients as a safe haven from confiscation. Particularly in comparison to other jurisdictions where government intervention and control are more advanced, the United States is being viewed increasingly as a safe haven from political instability and property confiscation.

ADEQUACY OF INFORMATION

The final tasks of the Treasury Department under the Study Act were to study the adequacy of our information and reporting programs on foreign portfolio investment and to recommend means by which this information can be kept current.

The information which we now have on foreign portfolio investment in the United States is of two kinds. One is a record of the transactions of foreigners in U.S. financial assets, which is collected, for the most part, on a monthly basis. The other is a record of the amount outstanding of foreign portfolio investment as of given dates, i.e., an inventory of foreign holdings of financial assets in this country.

The benchmark survey just completed for foreign holdings gives a comprehensive and detailed inventory of these holdings as of the end of 1974. For a limited time we will be able to update the major categories of this inventory reasonably accurately by adding (or subtracting) our monthly data on foreign portfolio investment into the 1974 benchmark figures and applying estimated changes in the market value of foreign holdings.

Our data on transactions give a breakdown of foreign purchases and sales of U.S. stocks, corporate and other non-Federal bonds, and U.S. Government securities. In addition, we collect monthly and quarterly data on outstanding amounts of long-term bank and non-bank liabilities to foreigners respectively. All these data series are broken down by the countries of residence of the foreign investors.

As time moves on, the 1974 composition of these holdings can be expected to change and the estimates of market values will gradually become less accurate. It might be desirable to undertake another benchmark survey at some time in the future, therefore. However, the 1974 benchmark survey along with our monthly reporting program will suffice to give us a reasonably accurate inventory of foreign portfolio investment in the United States for at least several years; thus the decision as to when another survey should be undertaken should be left for the future. The decision can then be made on the basis of how much the increased accuracy of the data would be worth as compared to the costs involved to both the Government and the private sector in undertaking a survey.

The results of the benchmark survey suggest that there is some underreporting bias in our reporting program for data on transactions, which was not unexpected. However, the differences between the totals reported by the survey and those which had previously been estimated do not appear unduly large, in view of the long period of time that has elapsed since the previous benchmark in 1941 and the significance of the non-transaction factors affecting the investment position totals. It is noteworthy that the difference is substantially larger in the figures on equity holdings, where the valuation adjustments problem is greatest, where the valuation adjustment problem is greatest, than it is for holdings of debt instruments. The survey results thus do not appear to raise major questions about the current reporting system.

While the conceptual and institutional structure of our reporting system appears to be adequate it will be necessary to constantly monitor the reports and to maintain close communication with the reporting firms to ensure that there are no major gaps in our reporting network. The benchmark survey results have given us some indications of avenues which can usefully be explored for this purpose.

Legislation recently introduced in the U.S. Senate will, if enacted, provide the Government with broader authority to collect information on foreign portfolio investment. Heretofore, the Treasury Department has been relying on a patchwork of laws to collect data on transactions, laws which are either clearly lacking in some respects or ambiguous as to the extent of their authority. The authority under which data for the benchmark survey were collected, the Foreign Investment Study Act, was temporary and has now expired.

Digitized by Google

The International Investment Survey Act of 1975 (S. 2839) would provide clear and permanent authority to collect data on all forms of inward and outward investment and it has been supported by the Treasury Department with certain suggested amendments.

THE DEPARTMENT OF THE TREASURY,
Washington, D.C., June 1, 1976.

Hon. DANIEL K. INOUYE,
Chairman, Subcommittee on Foreign Commerce and Tourism, Committee on Commerce, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed are answers to the questions you posed in your letter of May 6, pursuant to the hearings the Subcommittee on Foreign Commerce and Tourism held on foreign portfolio investment in the United States.

I appreciated the opportunity to share the results of the Treasury's study with you.

Sincerely,

GERALD L. PARSKY.

Enclosure.

Question 1. Was the Treasury able to determine how much of the corporate debt is convertible into stock or such that it might have had the effect of giving the foreign holders a major voice in the management of the issuing American company?

Answer. Treasury required reporters to provide information on the magnitude and distribution by country and type of holder of convertible bonds and debentures. The market value of these foreign-held convertible issues was about $2.7 billion at 1974 year-end prices, compared to foreign holdings of equity of $24.7 billion. These issues of convertible bonds and debentures were spread among many industries, with no industry accounting for more than 11 percent of the total.

Thus, the additions to foreign holdings of U.S. equity that would result from conversion of these bonds would generally not be of sufficient size to give foreign holders a major voice in the management of the issuing American companies. It should also be kept in mind that the foreign holders of the convertible bonds and debentures of any U.S. company are actually likely to be a great number of unaffiliated investors of different nationalities, lacking the ability to act in concert to influence the management of that firm.

Lowering the threshold for disclosure to one-half of one percent of a corporation's equity, as provided for in the bill, would lead to excessive intrusion into the private financial affairs of individuals.

These provisions raise serious potential difficulties with respect to their enforcement in the case of foreign nominees subject to the privacy laws of the countries in which they are located. In addition, U.S. brokers would have to assume the burden of policing transactions in order to avoid non-compliance.

We understand that the Securities and Exchange Commission plans to revise the proposal it made in August 1975 for changes in its regulations relating to reporting on corporate ownership—including changes relating to identification of the nationality of beneficial owners. When we have had an opportunity to examine the revised version, we will consider whether the Treasury should take a position on it. Thus far, we have not considered any proposals of our own for action in this area.

The results of the survey on inward portfolio investment show that amounts previously estimated for foreign holdings of U.S. stocks were undervalued by more than 37 percent when compared to the results of the new benchmark. Since the Treasury benchmark surveys underlying the old data are about equally old (1941 for inward investment and 1943 for outward investments), the outward portfolio holdings (especially stocks) may well be off by a similar percentage.

In addition, it should be noted that, as regards outward investments in foreign securities, the Treasury has no means to estimate the extent of direct transactions over the years of U.S. investors with foreign brokers and other foreign security dealers. If these resulted in significant additions to our stock of holdings of foreign securities since 1943, our estimate of our portfolio assets may be still further out of line.

Digitized by Google

Question 2. There has been concern both in the Congress and the SEC about the need for greater disclosure of the names of beneficial owners. Action on S. 953 has been temporarily postponed. What is the position of the Department of the Treasury with respect to the disclosure provisions of S. 953 and the SEC proposal?

Does the Department have before it any proposal to make this information more readily available?

What is the chance that the outward portfolio investment figure is also undervalued in the same 20% range or greater or less?

Answer. The Treasury Department is opposed to the enactment of the disclosure provision of S. 953 because we do not believe that a good case has been made to date that such detailed disclosure of the beneficial ownership of U.S. corporations is necessary to protect investor or essential U.S. interests. Until it can be demonstrated that the benefits to be derived from requiring disclosure in such detail would outweigh its negative effects, we believe that such legislation would be premature.

Some of the negative aspects of this proposal include the following:

Substantial costs would be borne by financial intermediaries such as banks and brokers that would be required to report their aggregate holdings of U.S. corporate securities as holders of record on behalf of investors.

Lowering the threshold for disclosure to one-half of one percent of a corporations's equity, as provided for in the bill, would lead to excessive intrusion into the private financial affairs of individuals.

These provsions raise serious potential difficulties with respect to ther enforcement in the case of foreign nominees subject to the privacy laws of the countries in which they are located. In addition, U.S. brokers would have to assume the burden of policing transactions in order to avoid non-compliance.

We understand that the Securities and Exchange Commission plans to revise the proposal made in August 1975 for changes in its regulations relating to reporting on corporate ownership—including changes relating to identification of the nationality of beneficial owners. When we have had an opportunity to examine the revised version, we will consider whether the Treasury should take a position on it. Thus far, we have not considered any proposals of our own for action in this area.

The results of the survey on inward portfolio investment show that amounts previously estimated for foreign holdings of U.S. stocks were undervalued by more than 37 percent when compared to the results of the new benchmark. Since the Treasury benchmark surveys underlying the old data are about equally old (1941 for inward investment and 1943 for outward investments), the outward portfolio holdings (especially stocks) may well be off by a similar percentage.

In addition, it should be noted that, as regards outward investments in foreign securities, the Treasury has no means to estimate the extent of direct transactions over the years of U.S. investors with foreign brokers and other foreign security dealers. If these resulted in significant additions to our stock of holdings of foreign securities since 1943, our estimate of our portfolio assets may be still further out of line.

Question 3. In your explanation of the reasons for investment in the United States, you mention political stability and safety as one of the motivations. Do you believe this is also a reason for foreign direct investment, especially for 1975–1976, years not covered in the benchmark report?

Answer. Political considerations are among the factors any prudent investor takes into account in evaluating the risks attached to an investment opportunity in another country. Our interviews indicated that foreign portfolio investors are attracted to the United States because they consider this country to be politically stable and therefore a safe place to invest their funds. Presumably, foreign direct investors also find this a positive factor in their decisions as to whether or not to invest here. Since this stability has been a long-term phenomenon, we would assume further that it has played a part in the decisions of foreigners to invest in the United States since 1974, as well as during the period covered by our study.

Questions 4. How much of the foreign-owned stock was bought on margin?

Answer. The survey did not collect any information on stocks purchased on margin. However, the research done by R. Shriver and Associates indicates that foreigners make very little use of margin accounts in the United States.

Question 5. On page 9 of your statement you remark that more participation in

Digitized by Google

U.S. securities markets tend to make them deeper and more efficient, and that consequently foreign participation is beneficial. In the summary, the issue of "capital inflows" is addressed. The Department's analysis contends that it is questionable how much new capital is imported and that it may be immaterial as to how much new capital actually flows into the U.S. Is capital inflow from equity purchases by foreigners measured; if it is, what does it show, if anything?

Answer. The term "capital inflow" is generally used to refer to foreign acquisitions of financial assets in the United States, including stocks and bonds. The Treasury Department collects *and* publishes monthly data on such acquisitions of stocks and bonds. Net foreign purchases of U.S. stocks in recent periods were as follows:

	Millions
1972	$2,188
1973	2,790
1974	540
1975	4,465
1976, Jan.–Feb	868

As noted in the summary, however, the characterization of these purchases as "capital inflows" can be misleading since foreign purchases of U.S. securities usually involve merely a change in the form of U.S. assets held by foreigners, e.g., the drawdown of the foreigner's U.S. bank account by an amount equivalent to his purchase of U.S. stock. Nevertheless, as I pointed out in my testimony (pages 9 and 17), the participation of foreigners in our capital markets is beneficial because it broadens the market for U.S. securities and thereby the opportunities for American firms to acquire the financing needed for new investments. This point is discussed at more length on pages 33 and 34 of the summary attached to my statement.

Question 6. The summary report indicates that we may have underestimated dividend and interest distribution from portfolio investments by several hundred million dollars. When distribution from direct investments is added, this correction may total several hundred million dollars more. Approximately, what has been the aggregate total of hitherto unreported and unknown outflows?

Answer. The new survey calculated dividend and interest income at an annual rate of $4.2 billion, based on the assumption that the investments held as of December 31, 1974 were held throughout the year. The balance of payments accounts for 1974 reported income payments on foreign portfolio account as about $3.7 billion.

However, since foreign holdings increased in that year, the $4.2 billion estimate may have been somewhat larger than was actually paid out during 1974 to foreign portfolio investors. The shortfall of unreported and unknown income payments to foreigners in 1974, therefore, was probably considerably less than $500 million, and of lesser amounts for earlier years. If known and recorded, these additional outflows would have resulted in a correction of transactions in the balance of payments and would accordingly have affected the "Errors and Omissions" account.

Question 7. How many companies and/or individuals refused to cooperate in the study?

What action, if any, was taken against them pursuant to the provisions of the Act, which provided penalties for non-compliance?

Answer. The public response to the requirement to file the needed reports in the Treasury survey was very good, largely because of the widespread recognition of the value of such data at this time. Only one small company refused to file its report, partly because of special problems they would encounter—the company allegedly became aware of the reporting requirement only in November of 1975—and partly in protest against what they considered unreasonable Federal reporting requirements for small businesses. The Treasury decided not to pursue this matter through the courts because the impact of the missing data was too small to create any noticeable effect on the data already collected.

Question 8. The Treasury Department has indicated support for S. 958, a bill to regulate foreign banking. This appears to be an unusual situation since there are many mitigating factors which would appear to require the implementation of a national regulatory policy on foreign banking. Are there other industries which at this time are suffering from dual regulation, such as insurance, which might also benefit from uniform regulation?

Answer. We believe that the circumstances with respect to regulation of foreign banking here are unique. We are not aware of any other sectors in the

Digitized by Google

U.S. economy which would require a new regulatory regime for foreign investors such as that provided for in S. 958.

Question 9. How many countries have formally agreed to consult with the United States before making government investments here?

How many countries have you and other Administration representatives visited to discuss this issue in addition to the countries listed above?

Will the Administration seek to conclude other agreements with these countries?

Answer. As part of the new administrative arrangements with respect to foreign investment in this country announced last year, we have advised all foreign governments that the United States will expect any foreign government contemplating a major direct investment here to seek advance consultations with the U.S. Government on the prospective investment. We are flexible regarding the modes by which such consultations take place. For the most part, we expect that traditional diplomatic channels will be used; in other cases more formal mechanisms, such as the joint commissions we have established with a number of countries, may be appropriate.

We have had clear indications that other governments recognize our legitimate interests with respect to their investments in this country. The major potential governmental investors of the Middle East—Saudi Arabia, Kuwait, Qatar, the U.A.E., and Iran in particular—have expressed a broad acceptance of our desire for consultations in our discussions with them. Saudi Arabia, in fact, has agreed, as stated in a Saudi-U.S. joint communique on February 27, 1975, to consult closely with the U.S. Government on significant productive ventures here. We do not intend to seek formal arrangements for consultations with any additional countries because we do not believe that this would be necessary.

Question 10. Is the Department prepared to work with the Office of Foreign Investment to implement needed changes to improve the collection of data by U.S. agencies?

Answer. We will certainly give the Department of Commerce any assistance we can in support of its efforts to bring about improvements in the U.S. Government's collection of data on foreign investment in the United States.

Question 11. You have indicated that the Administration supports my bill S. 2839 if certain changes were included. What is the Administration's position on S. 3151, Senator Church's bill?

Answer. The Administration is opposed to S. 3151. One problem we have is that it relates only to direct investment abroad by Americans. Thus, it does not go far enough in giving the additional authority needed to collect data in the foreign investment area as a whole.

Another problem is that it is too specific as to the information to be collected. Similarly, the bill does not allow any flexibility to add or subtract items in accordance with changes in perceptions as to what information is needed.

A third difficulty is that in requiring that surveys be conducted every two years, S. 3151 would place an excessive and unnecessary paper work burden on both American investors and the Federal Government. Businesses would incur substantial expenses in complying with the bill's record keeping and reporting requirements, and the Government would have to add to the Federal bureaucracy in order to assume the burden of collecting and processing the reports.

Question 12. Were there any unexpected facts arising from this new information in the study, and if so, what were they?

Answer. The study generated a large amount of new information on foreign portfolio investment in the United States but no significant new facts which were unexpected in the sense of being surprising.

U.S. DEPARTMENT OF COMMERCE,
OFFICE OF THE SECRETARY,
Washington, D.C., June 4, 1976.

Hon. DANIEL K. INOUYE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR INOUYE: In response to your letter of May 6 I am transmitting herewith the responses to your questions on foreign direct investments in the United States which follow up on the May 3rd hearings of the Subcommittee on Foreign Commerce and Tourism. The responses were drafted by Mr. George

Digitized by Google

Kruer's staff in the Bureau of Economic Analysis and the Office of Foreign Investment in the United States. I trust that you will find the responses satisfactory, and will be pleased to provide further responses if needed.

Sincerely,

MILTON A. BERGER,
Director, Office of Foreign Investment in the United States.

Enclosure.

Question 1. How much of the survey is completely new in its coverage and how much in the way of statistical data was covered in the 1959 report?

Answer. The 1974 benchmark survey significantly added to the stock of information available on foreign direct investment in the United States. The focus of the 1959 report was primarily on those data items needed to calculate the direct investment position, related balance of payments transactions, and the foreign parents' shares in their affiliates' earnings. Balance sheets and statement of income and earned surplus of U.S. affiliates were the only other major data items collected on the 1959 report.

Data which were collected for the first time in the 1974 survey included: (1) merchandise trade of U.S. affiliates; (2) employment and employee compensation of U.S. affiliates; (3) gross fixed assets by use category and by state; (4) other detail by state, including employment, sales, and land and minerals rights; (5) sources and applications of funds of U.S. affiliates; (6) other supplementary financial data of U.S. affiliates, including research and development expenditures; (7) detail on the assets, revenues, and industry classification of foreign parents; and (8) detail at the three-digit SIC level on the industry of U.S. affiliates. New detail was also included in U.S. affiliates' balance sheets and income statements. The sections of the report dealing with the direct investment position, related balance of payments transactions, and foreign parents' shares in their U.S. affiliates' earnings were expanded and refined to ensure more complete coverage.

Question 2. The 1974 Study Act provided for penalties for companies or individuals who refused to comply with the reporting provisions. Were the penalties imposed on uncooperative firms and, if not, why not, in view of the Congressional determination?

Answer. None of the penalties provided for by the 1974 Study Act were imposed on uncooperative firms. Overall we received good cooperation from the vast majority of firms contacted. To the best of our knowledge, no foreign owned U.S. firm with significant foreign investment failed to file a report.

It is clear that if the Study Act had not contained penalty provisions for noncompliance, the results would not have been as complete. By the April 30, 1975 due date only 3,000 reports, or 41 percent of the universe of 7,200 reports which were ultimately filed, had been filed. On May 30, 1975, 5,600 reminder letters were mailed; and on July 21, 1975, a second mailing of 1,900 reminder letters were sent out, this time by certified mail. The ability to cite specific penalty provisions contained in the Foreign Investment Study Act of 1974 in the reminder letters sent to prospective respondents helped secure compliance.

On September 24, 1975, BEA submitted to the Commerce Department's Office of General Counsel information relating to 70 firms which had failed to cooperate. Some of the firms had filed incomplete and/or inaccurate reports and ignored requests to amend them, while other firms had not responded at all. Over one third of the 70 firms ultimately responded as a result of continued efforts; however, because of the time schedule set up for the submission of the report to Congress and a lack of manpower, as well as the uncertainty (lack of evidence) as to whether or not these firms were in fact foreign owned, it was decided not to proceed with the prosecution of these firms. BEA is still receiving a few scattered replies. Although many requests for data are still outstanding, we do not know whether these firms are actually required to report. However, based on what we do know about these firms, we felt that they would have an insignificant impact on the data and would not have justified delaying the final report to the Congress.

At the request of the Department of Commerce's Office of General Counsel, on October 20, 1975, detailed backup material was sent to that office covering two firms which we were absolutely sure were foreign owned and thus required to file reports pursuant to the Act. As a result of contact with the firms by the

Digitized by Google

Department's Office of General Counsel, both companies ultimately reported. One report was received on February 25, 1976 and the other on April 21, 1976.

Question 3. On Page 3 of the statement, it is noted that the data cover "directly measurable U.S. balance of payments transactions". Are there indirect transactions which may have a significant financial impact but which, for quantitative reasons, were not measured?

Answer. Rather than indirect transactions, it might better be said that there are indirect effects which cannot be measured. The best example of this is the trade effect of a new direct investment. For illustrative purposes, assume that a foreign company which had manufactured goods in its home country and exported the finished product to the United States sets up a plant in the United States to manufacture the same product here. U.S. imports from the foreign country will decline. The extent of the decline in imports is unknown—the foreign parent may ship components to the United States, and assemble the product here.

In addition to indirect trade effects, there are also likely to be indirect financial effects, as parents and affiliates change borrowing and lending patterns vis-a-vis the United States.

Question 4. The FDI position was $26.5 billion at yearend 1974. Based on this figure, what is the projected yearend 1975 figure?

Answer. From reports received to date in BEA's quarterly sample surveys of foreign direct investment in the United States, it is estimated that the change in FDI position in 1975 will be on the order of $4.0 billion. This figure is preliminary and tentative, since not all 1975 reports have been received to date; it may be revised substantially before publication, which is scheduled for August. If it were added to the $26.5 billion position at yearend 1974 that was obtained in the benchmark survey, it would imply a yearend 1975 position of about $30.5 billion.

It should be noted that the 1975 estimates to be published in August will update the old series, and, like the old series, will be benchmarked to the 1959 survey. When the series are published next year, they will be rebenchmarked to the 1974 survey and the annual change and, therefore, the yearend position may be significantly different because of expected improved coverage in the sample surveys, as a result of the 1974 benchmark survey.

Question 5a. You note on page 5 that the investment position increased $5.1 billion during 1974. This appears to be a significant increase over the official earlier figure. Why was this revised upward?

Answer. The earlier investment position increase of $3.5 billion was $1.6 billion below the benchmark survey's increase of $5.1 billion. The difference consists almost entirely of an understatement of net capital inflows, which were $2.2 billion in the old series and are $3.8 billion in the benchmark survey.

The better coverage of transactions of U.S. affiliates with foreign affiliates of foreign parents accounted for a significant proportion of the higher net capital inflow figure. Another major factor was the cross-checking which was effected in the benchmark survey to ensure that transactions, particularly acquisitions, were reported at market or transactions value, and not at book value. Better coverage of the real estate and banking industries was also a factor, as was the inclusion of the 10 to 24 percent-owned U.S. companies.

Question 5b. Does this upward revision indicate need for changes in the manner we track inflows of capital?

Answer. Yes. Coverage of capital flows will be improved by the inclusion of additional companies in the sample surveys from which current data are secured. The benchmark survey results indicate that there must be more emphasis on the collection of data on the transactions of U.S. affiliates with foreign affiliates of foreign parents.

Question c. How does this campare to outflow of outward U.S. direct investment in the same year?

Answer. Based on the benchmark survey, the foreign direct investment position in the U.S. increased $5.1 billion, consisting of net capital inflows of $3.8 billion, reinvested earnings of $1.6 billion, and small negative valuation adjustments. The U.S. direct investment position abroad for the same period increased by $15.0 billion, consisting of net capital outflows of $7.4 billion, reinvested earnings of $7.5 billion, and negligible valuation adjustments. The increase in U.S. direct investment abroad was almost three times the increase in foreign direct investment in the United States.

Digitized by Google

Question 6a. Adjusted earnings were $6.6 billion and distributions to parents were $5.1 billion. How does this compare to our earlier estimates?

Answer. The previously published 1974 estimate for adjusted earnings was $7.0 billion and for balance of payments income (distributions to foreign parents) $5.4 billion. The lower figures in the benchmark survey data for these items are almost entirely due to a change in definition. In the previous estimates, the foreign parents' shares in the earnings, adjusted earnings, and reinvested earnings of their U.S. affiliates were defined to *exclude* unrealized capital gains and losses; where possible, a valuation adjustment to the direct investment position was made at the end of each year to reflect such unrealized gains or losses. In the benchmark survey, earnings-related items were defined to *include* unrealized capital gains or losses and therefore no valuation adjustment was required to be made.

Although the change applied to all U.S. affiliates, its affect was greatest on those in the insurance industry. The value of insurance affiliates' investment portfolios declined substantially in 1974 and their adjusted earnings reported in the benchmark survey included large unrealized losses which were excluded from the previous estimate. Furthermore, most insurance affiliates are branches (unincorporated), and since branch earnings are a component of balance of payments income, the change in definition also lowered the benchmark survey figure for balance of payments income compared with the previous estimate.

Question b. How does this compare to U.S. companies' returns from their foreign investments?

Answer. In 1974, adjusted earnings were $25.2 billion for U.S. direct investment abroad; balance of payments income receipts were $17.7 billion.

Question c. Doesn't this mean greater outflow of capital than previously believed?

Answer. As noted, the benchmark survey figure for balance of payments income flows was lower than the previous estimate, although the difference was due largely to treating unrealized capital gains and loses as part of affiliates' earnings rather than as valuation adjustments to the direct investment position. It is unclear whether this change in treatment will raise or lower income flows in the future. In 1975, for example, with the improvement in the U.S. stock market, it is known that insurance branch affiliates had large unrealized capital gains; this will tend to increase balance of payments income flows on foreign direct investment in the United States in 1975.

Apart from this change in treatment, balance of payments income flows may be somewhat higher in the benchmark survey than in the previous estimate because of better coverage. However, it will not be possible to be certain of the direction or magnitude of the difference due to better coverage until rebenchmarking is completed.

Question 7. Of the $26.5 billion total, $1.1 billion is in unincorporated affiliates. Of what does this consist besides partnerships and individual investors?

Answer. Of the approximately 7,200 reporters, 969 were unincorporated. In addition to partnerships and individual investors, unincorporated affiliates include joint ventures and branches. The latter is probably the most significant and is defined as: (a) the operations or activities conducted by an incorporated or unincorporated person in its own name in a different location, but not through an incorporated entity; and (b) the U.S. business of foreign mutual insurance companies.

Investment in two major groups account for over 75 percent of the $1.1 billion foreign direct investment position in unincorporated affiliates. They are U.S. branches of foreign insurance companies, which account for $627 million, and real estate holdings, which account for $227 million.

Question 8. In view of the leverage Japanese affiliates exercise, would it be appropriate to say that Japanese investors have a greater influence than their apparent nominal FDI position would seem to indicate?

Answer. The FDI position in Japanese affiliates was only $0.1 billion at yearend 1974, less than 1 percent of the position in all affiliates. The small size of the Japanese position was due to the fact that position figures are derived by netting any investment by U.S. affiliates in their foreign parents against the foreign parents' investment in their U.S. affiliates; usually investment by affiliates in their parents in relatively small. However, in the case of Japanese-owned affiliates, such investment—mostly in the form of loans to their parents (affiliate receivables)—has in recent years been very large. Thus, at the end of 1974, sub-

Digitized by Google

stantial net equity investment in, and loans to, incorporated affiliates by their Japanese parents, totaling $2.6 billion, were nearly offset by the $2.2 billion in loans to Japanese parents by incorporated affiliates and the $0.3 billion negative Japanese investment position in unincorporated affiliates.

Other data collected in the 1974 survey indicate that the net position figure may understate the economic significance of Japanese investment. For example, U.S. affiliates of Japanese parents accounted for 22 percent of total assets, 42 percent of U.S. exports, 35 pjercent of U.S. imports, and 27 percent of sales by all U.S. affiliates. All of these proportions are the largest for any single country.

Question 9. From the graphs in the appendices, it appears that foreign affiliates totally dominate the area of food exports and imports. Does this situation arise because of the dominant role which foreign companies have in grain merchandising?

Answer. Of the total U.S. exports of food, beverages and tobacco, foreign-owned U.S. companies accounted for nearly 80 percent. Exports by grain merchandising affiliates accounted for almost two-thirds of this share, and about one-half of total U.S. exports of food grains, feed grains, and oil seed and meals.

Foreign-owned firms accounted for about 29 percent, $3.1 billion, of total U.S. imports of food. However, imports by grain merchandising firms were not significant; more than two-thirds was by other wholesale trade affiliates.

Question 10. The FDI survey covered certain types of real estate. In the statement it is noted that information on foreign ownership of agricultural land and other real estate is inadequate. Precisely what kinds of real estate investments were covered and why were these but not other types of real estate investments surveyed?

Answer. Reports were required to be filed covering all real estate in the United States owned by foreign persons for business purposes, thereby excluding property held exclusively for personal use and not for profit-making purposes. All other forms of investment in real estate were covered.

The inadequacy of information in the statement refers to the lack of hard, factual data in regards to being able to identify the beneficial owners of land and/or their citizenship even using information in local government land records. Since this type of investment is not as visible as an industrial plant, if the ultimate legal ownership is not public knowledge it is virtually impossible to seek out and locate parcels of land which are foreign-owned directly, or indirectly through other U.S. companies.

We were aware of the problem prior to conducting the survey and made an extra effort to obtain information on foreign ownership of real estate. Approximately 80 real estate information sources were contacted in preparing the mailing list. In addition, real estate journals and associations were alerted to the filing requirements covering such investment. In all publicity statements, the fact that foreign-owned real estate was required to be reported was explicitly spelled out. As a result, we received reports from 1,043 real estate affiliates, 121 agricultural affiliates, 82 mining affiliates, 69 affiliates classified in the hotel industry, and 7 country clubs. These represent over 18 percent of the total 7,204 reports received. Also, all affiliates, regardless of industrial classification, were required to report the number of acres of land owned if the total exceeded 200 acres.

One example of the difficulties in securing accurate identifying information concerns foreign-owned agricultural land in Iowa. No reports were filed in the benchmark survey covering such investment. However, a special study conducted under contract to the U.S. Department of Agriculture by Iowa State University reports several purchases of Iowa farmland by German nationals in 1974. We tried to secure names and addresses from the U.S. Department of Agriculture and the State of Iowa in order to verify these transactions and/or secure names and addresses of owners or U.S. managers who would be responsible for filing under the provisions of the Study Act. We have been unable to verify any purchases made during 1974. As is so often the case, common knowledge about foreign investment in real estate is difficult to support with facts and often may be inaccurate.

In addition to the benchmark survey, the Department of Agriculture, sponsored by the Department of Commerce, contracted for 21 studies from economists, political scientists, sociologists, and lawyers from several universities and research agencies. The studies covered a wide range of subjects related to real estate, including characteristics of foreign purchasers of farmland in the United

Digitized by Google

States, U.S. timberland and forest industry, land information systems, and disclosure in ownership reporting systems.

A discussion of foreign investment in U.S. real estate will be included in the report to Congress and relevant Department of Agriculture studies will be included as an appendix.

Question 11a. How do you account for the large position which foreign firms have in international trade to the point they dominate U.S. food exports and imports and trade with Japan and Germany?

Answer. Much investment by foreign firms in the United States has been concentrated in establishing trade affiliates to act as both sales and purchasing agents for their foreign parents. Investment in wholesale trade affiliates accounted for 16 percent of the foreign direct investment position in all U.S. affiliates. The large investment in these affiliates may be an example of the so-called "product cycle hypothesis" which suggests that firms initially export to foreign countries themselves, then establish sales offices in the foreign countries to market their goods for them, and finally begin to manufacture goods abroad by setting up production facilities in the foreign countries. Many foreign direct investments in the United States seem to have evolved to the stage where the foreign firms have established trade affiliates here, although some firms which traditionally have sold their goods through trade affiliates have begun, or are planning to begin, production in the United States. Examples are Volvo, which is now constructing a plant here, and Volkswagen, which appears to have recently decided to build a plant here.

All U.S. affiliates accounted for 94 percent of U.S. export, and 86 percent of U.S. import, trade with Japan, and 37 percent of U.S. export, and 67 percent of U.S. import, trade with Germany. Wholesale trade affiliates, in turn, accounted for 85 percent of the exports to, and 88 percent of the imports from, Japan, and 88 percent of both the exports to and imports from Germany, by all U.S. affiliates. Thus, substantial investment in wholesale trade affiliates in the United States in large part explains the importance of U.S. affiliates in trade with both Japan and Germany.

Affiliates are also important in U.S. trade of food products. They account for nearly 80 percent of U.S. exports and 29 percent of U.S. imports of these goods. Nearly two-thirds of their exports are shipments of grain. The particularly large share of affiliates in U.S. exports of foods probably reflects heavy dependence by foreigners on the United States for basic food supplies.

Question b. In your view, is this large impact on our foreign trade one of the significant findings of the Commerce Department study?

Answer. Yes. This was a major finding of the study. As indicated in the testimony, U.S. affiliates of foreign parents accounted for a substantial proporation of U.S. merchandise trade in 1974—$24.2 billion, or 24 percent, of total U.S. exports and $30.5 billion, or 30 percent, of total U.S. imports.

Question 12. Do you think it would be worthwhile to study the conduct of foreign investors to examine, in particular, intercorporate dealings? For example, to examine pricing policies, competition, capital transfers, etc.

Is the Office of Foreign Investment in the Commerce Department capable of doing this?

Answer. The United States operations of foreign investors are, of course, subject to our Federal and state laws and to the scrutiny of the regulatory agencies. The SEC, IRS, Justice, FTC, and other regulatory agencies, pursuant to their statutory responsibilities, review and investigate the operations and intercorporate dealings of foreign-owned companies, as required, and on the same basis as U.S.-owned firms. Such reviews and investigations cover securities sales and purchases, pricing policies, competition, and intercorporate financial dealings in relation to the enforcement of our securities and tax laws and the laws dealing with competition and restrictive business practices. To subject foreign firms to additional inquiry and investigation by other agencies regarding such matters would be inconsistent with our policy respecting national treatment of foreign investors.

Apart from this paramount consideration, the Office of Foreign Investment in the United States does not have the statutory power to require foreign companies to subject their operations and records to investigation. Moreover, its personnel are statisticians and economists recruited to monitor foreign investments here, primarily from data supplied by other agencies, and to evaluate their impact on the U.S. economy. It is, of course, important to know whether foreign

Digitized by Google

firms in the aggregate are conforming to our laws and the extent and manner that their business practices and intercorporate dealings differ from those of U.S.-owned companies. For the present, we believe that the regulatory agencies will be able to provide us the required aggregate date.

Question 13. Page 8 of the statement points out that generally with the exception of petroleum refining, foreign affiliates do not account for a large percentage of any industry's output. Is it not true, however, that such gross categories obscure the significance of foreign affiliates in narrower markets? For example, in the banking industry, where they play a large role in marketing certain kinds of securities or in ball bearing manufacturing.

Answer. Volume 3 of the report on Foreign Direct Investment in the United States will provide information on the position of foreign-owned U.S. firms in specific product markets. It states, for example, that in man-made fibers such firms account for about 26 percent of the U.S. industry's capacity, while in antifriction bearings their production facilities in this country provide 15 percent of the industry's shipments.

Commercial banks do not normally market securities except for those issued by Federal, state or local governments, which they are permitted to buy and sell. Of course, the trust departments of banks trade in securities for the accounts of their customers. A number of foreign banks have securities affiliates in the United States which presumably engage in the marketing of securities, but we have no solid information as to the size or importance of their activities. It is our impression that most of these affiliates are relatively small and account for only a minor part of the total volume of securities sold in the United States.

Question 14. It has been suggested that one of the reasons for FDI in this country has been fear of overseas political developments. This benchmark covers only 1974. Nevertheless, was your survey able to detect this, but even if not, do you think that there is any substance to this speculation?

Answer. The benchmark survey was not able to detect this, but a study of factors motivating foreign companies to invest in the United States was undertaken by a private organization, under contract to the Department of Commerce. The results of this study, which was based in large part on personal interviews with executives of 72 foreign parent companies with direct investments in the United States, indicate that foreign political developments, either in the home country or in other foreign countries, were a factor in the decision to invest in the United States. The importance of this factor varied among countries, and was not cited as the key determinant. Other factors, such as costs of production and marketing objectives, were usually more important. Nevertheless, foreign political developments seem to be one of the significant factors in the recent increase in foreign direct investment in the United States. Factors motivating foreign investment will be discussed in the report to Congress and the contract study will be made available.

Question 15. On the basis of the two studies on data collection, is the Office of Foreign Investment prepared to follow up on means to improve data collection activities? When can the Congress expect to see the first changes in this area?

Answer. The Office of Foreign Investment in the United States has contacted all of the agencies identified in the two earlier studies on data collection, and has arranged to receive relevant information on a regular basis. In addition, the Office will recommend actions to those agencies currently gathering data in order to improve reporting regulations, instructions, and forms as they relate to data on foreign investment in the United States.

Information that is being received is currently being used by that Office to identify and monitor investment transactions. Information on new investment transactions, as well as those that occurred in 1974 and 1975, has been incorporated in a computerized data system that provides the Office with the capability to retrieve quickly information on specific transactions, as well as to aggregate and analyze selected data elements (e.g., assets, sales, net worth, employment). A report on foreign direct investments in U.S. companies during 1974 and 1975 is being prepared and will be submitted to the Congress.

On the basis of this benchmark survey, can we anticipate that there will be changes in the way that data is collected? Can we expect, for example, that the aggregate figures for the previous year can be obtained earlier than in August—as is now the case?

Answer. Yes. We have already changed the coverage of foreign direct investment in the sample surveys to include 10–24 percent foreign-owned U.S. busi-

Digitized by Google

ness enterprises. As a result of the benchmark survey, we will also be adding a number of reporters, in addition to those 10–24 percent foreign-owned, to the group of 450 which are presently reporting in the sample surveys. The benchmark survey also showed that we need to ensure better coverage of the transactions and positions with foreign affiliates of foreign parents. These are much more significant in the benchmark survey than in the sample survey and we were not aware of this.

We do expect to advance the availability date of the previous year's data, although this improvement is unrelated to the benchmark survey. The reason that we have been unable to publish the position data earlier is the lack of data on reinvested earnings, a major component of the annual change in the position. A company's earnings were reported on an annual basis only, the bulk of them on the report filed in May of the following year. Annual earnings less dividends paid (which were reported on a quarterly basis) for the year yielded reinvested earnings. We had started collecting earnings quarterly and will now be able to get an annual earnings figure once the fourth quarter report for the year is filed, usually in February. This will be three months earlier than the present date for which an annual earnings, and thereby reinvested earnings, figure is available.

We are planning to incorporate this new quarterly data in the current series at the time they are benchmarked to the 1974 survey.

Question 16. Were there any surprises to you in the benchmark results?

Answer. A most interesting result of the survey was the distinctive pattern of Japanese investment. The Japanese direct investment position in the United States was quite small (less than one percent of the total) because parent company equity investment in, and loans to, their U.S. affiliates were largely offset by U.S. affiliates' loans to their Japanese parents. BEA's sample surveys had reflected this investment pattern in the past. What was surprising was that the benchmark survey revealed that this was not simply the investment pattern of a few large Japanese companies "swamping" the data, but rather that many Japanese-owned affiliates, large or small and regardless of industry, had substantial loans outstanding against their parents. A related factor was the magnitude and economic significance of Japanese investment in the United States according to measures other than the direct investment position. An example is that Japanese-owned affiliates accounted for 22 percent of all assets held by foreign-owned U.S. affiliates, the largest percentage of any country.

Another surprising aspect was the large proportion of U.S. merchandise trade accounted for by foreign-owned U.S. affiliates—24 percent of total U.S. exports and 30 percent of total U.S. imports. Related to this is the fact that they dominate trade in certain commodities and with certain countries.

Finally, there was the large increase in their liabilities during 1974, primarily to U.S. persons.

Question 17. In the response to one of the questions, it was agreed that American banks were financing the expansion of foreign direct investment. From the FDI data, is the Department able to determine whether such financing usually occurs at the beginning of an investment or whether a preponderance of foreign capital is initially used? What are other notable features about American financing of foreign direct investment in the U.S.?

Answer. The benchmark survey provides little data on this aspect of direct investment because, typically, the financing for new direct investment would be provided to the foreign parent and thus would not appear on the books of the newly acquired or established U.S. affiliate that itself would not be involved in the transaction. An exception would be where an existing U.S. affiliate acquires or establishes a new U.S. affiliate of the foreign parent.

The FDI survey does show, however, that for those U.S. affiliates which were either started or purchased by foreign parents during 1974, the increase in the U.S. affiliates' debt was primarily to U.S. sources, specifically 77 percent (39 percent with U.S. banks) and only 19 percent of the debt increase was with foreign parents.

A review of the change in the composition of external finances of U.S. affiliates reveals that there was a substantial increase—32 percent—in current and long-term debt of U.S. affiliates. Of the $27.0 billion increase in such debt, $18.4 billion was to U.S. sources, of which $10.3 billion was to unaffiliated U.S. banks, while only $4.4 billion of the increase was with foreign parents.

Digitized by Google

In addition to the benchmark survey, a report prepared by a contractor to the Department of Commerce studied the processes, mechanisms, and methods of financing foreign direct investment. This study was based on 69 cases of direct investment transactions. In the 69 cases, a total of 115 sources of funds were identified. 54 of the sources were in the United States, 10 were Eurodollar markets, and 51 were other foreign sources. Of the total amount raised, U.S. sources provided $658 million, $282 million was in Eurodollars, and $1.21 billion came from other foreign sources.

Several factors were found to be of importance to foreign investors in selecting the sources of funds. These considerations included:

Size of capital requirements which often leads to complex multiple-source funding;

Capital outflow restrictions in the investor's home country;

Parent company relationship with US. lenders; and

Parent company policies.

The subject of financing will be discussed in the Commerce Department's report to the Congress and the report of the contractor will be published as an appendix.

Digitized by Google

Digitized by Google

Digitized by Google

Digitized by Google

Digitized by Google

DEPOSIT
AUG 1 7 1976
SHIPPED
Digitized by Google

Y 4.C 73/2:94-79 C.1
Foreign investment stu
Stanford University Libraries

3 6105 045 203 010

DATE DUE

STANFORD UNIVERSITY LIBRARIES
STANFORD, CALIFORNIA 94305-6004

GAYLORD

Digitized by Google

Digitized by Google